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When Constitutional Challenges to State Cancellation Moratoriums Enacted After Catastrophic Hurricanes Fail: A Call for a New Federal Insurance Program

Steven Plitt* & Daniel Maldonado**

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INTRODUCTION

The hurricane season of 2005 has called into question how our nation deals with mega catastrophes. Some risks are too large or unpredictable to be insurable within the current institutional, financial, and regulatory frameworks that govern private insurance markets. Mega catastrophes may exceed the ability and capacity of private insurance markets to deal effectively with incidents of this magnitude.

Recent catastrophic homeowner property losses caused by hurricanes have shaken the insurance industry. The extent of the financial losses is staggering. Hurricanes are recurring phenomena. Because of the likelihood of future losses, some insurance companies determined that it would be in their corporate best interest to leave the residential homeowner insurance marketplace in the hurricane prone coastal states of Florida, Alabama, Mississippi, and Louisiana. Any large-scale withdrawal by major insurance companies would potentially undermine the residential homeowner insurance marketplace in those states. In response, the various departments of insurance within those states prevented large-scale market withdrawals through the post-hurricane implementation of emergency moratorium statutes and regulations. Insurance protectionism, in the form of regulatory withdrawal moratoriums, in the Gulf states or in other states prone to hurricanes can potentially threaten the solvency of insurance companies that are prohibited from withdrawing from these high-risk markets. The large catastrophic losses of a Category 4 or Category 5 hurricane can cause the failure of a regional or national insurance company. By preventing market withdrawal, these states may potentially jeopardize the continued solvency and viability of regional and national insurance companies, which may affect citizens of non-hurricane-affected states, and their respective state guaranty funds. After Hurricane Andrew, for example, almost a dozen insurance com-

panies became insolvent.¹ Insolvency not only results in the unavailability of insurance for those in the affected hurricane area but can also mean that insureds of those insolvent insurance companies in non-hurricane-affected states lose their insurance coverage and their respective state-guarantee funds may have to provide coverage for any non-hail-related claims. Consequently, imposition of emergency moratoriums is not the answer. The authors believe that the resolution for such catastrophic hurricane losses is a mandatory federal insurance program that shifts the costs to those living in hurricane-prone states throughout the entire region.

This Article proceeds as follows. Part I briefly discusses the financial consequences of recent and future hurricane seasons, which may require a federal hurricane-insurance program to cover losses in the future.

Part II discusses Hurricane Andrew and the emergence of non-cancellation moratoriums in the marketplace for residential-homeowner insurance adopted by the Florida Department of Insurance and the Florida Legislature. To some extent, Florida's example set the groundwork for the emergency moratoriums issued following the catastrophic losses from Hurricane Katrina in the states of Alabama, Mississippi, and Louisiana. Part II also discusses the Florida moratorium regulatory approach to catastrophic hurricane losses.

Part III introduces the foundation of America's dual-sovereignty system and summarizes the historical battle over jurisdiction to regulate the insurance industry.

Part IV explores possible constitutional challenges to emergency-hurricane moratoriums. A principle hurdle to constitutionally overcoming the moratorium regulations is proving that discriminatory *de facto* redlining would not occur from wholesale market withdrawals in the Gulf states and other states affected by hurricanes.

Part V discusses a possible federal solution to state moratorium protectionism. Part V-A discussed the possibility of federal legislation prohibiting state-imposed moratoriums. Part V-B explains why a federal catastrophic-insurance program is warranted because of marketplace dysfunction. Part V-C offers the creation of a federal hurricane-

1. Michelle E. Boardman, *Known Unknowns: The Illusion of Terrorism Insurance*, 93 GEO. L.J. 783, 830 (2005) (noting that nine insurers became insolvent after Hurricane Andrew and were allowed to exit the Florida insurance market completely); Mireya Navarro, *Storms Expose Florida's Vulnerability*, N.Y. TIMES (Oct. 13, 1995), <http://www.nytimes.com/1995/10/13/us/storms-expose-florida-s-vulnerability.html>.

insurance program as an alternative solution to emergency moratoriums. There is precedent for federal intervention. If the federal government does not enact a federal catastrophic-insurance program, then an alternative would be to pass the National Insurance Act allowing for federal chartering of insurance companies. Part V-D discusses federal charters as an alternative approach. Federally chartered insurance companies would not be subject to state regulatory withdrawal moratorium regulations. A federally chartered insurance company could withdraw from participating in providing insurance in identified hurricane risk areas.

I. LOSSES FROM PREVIOUS AND FUTURE HURRICANE SEASONS

Like floods, the devastation and financial consequences of hurricanes are staggering. The federal government through the Federal Emergency Management Agency (FEMA)² provides disaster assistance to individuals, families, and businesses whose property have been damaged or destroyed as a result of a flood and whose losses are not covered by flood insurance.³ Disaster assistance is available to pay for temporary housing, disaster-related medical and dental costs, disaster-related funeral and burial costs, clothing, fuel, moving and storage expenses, and other necessary expenses as determined by FEMA.⁴ Most federal disaster assistance “is in the form of loans administered by the Small Business Administration.”⁵ Federal disaster assistance, however, is not intended to restore any damaged property to the con-

2. President Jimmy Carter originally created FEMA by executive order in 1979 to centralize federal emergency functions. See Exec. Order No. 12,127, 3 C.F.R. § 376 (1980). The executive order transferred, among other things, the functions from the Department of Housing and Urban Development vested in the Secretary of Housing and Urban Development pursuant to the Federal Flood Insurance Act of 1956 § 15(e), 42 U.S.C. § 2414(e) (2012); the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, 42 U.S.C. §§ 4001–4129; the National Housing Act § 520(b), 12 U.S.C. § 1735d(b); and Title XII of the National Housing Act, 12 U.S.C. § 1749bbb. On October 4, 2006, President George W. Bush signed the Post-Katrina Emergency Reform Act of 2006, Pub. L. No. 109-295, 120 Stat. 1355 (2006) (codified at 6 U.S.C. §§ 701–900), which significantly reorganized FEMA within the Department of Homeland Security and provided substantially new authority to remedy gaps that became apparent in the response to Hurricane Katrina in August 2005.

3. *What is Disaster Assistance?*, FEMA.GOV, <http://www.fema.gov/what-disaster-assistance> (last updated July 18, 2012).

4. *Disaster Assistance Available from FEMA*, FEMA.GOV, <http://www.fema.gov/disaster-assistance-available-fema> (last updated Aug. 10, 2012).

5. *What is Disaster Assistance?*, *supra* note 3.

dition that it was in before the disaster.⁶ In Fiscal Year 2010, FEMA requested an extra \$600 million for its Disaster Relief Fund to support response, recovery, and mitigation efforts for presidentially-declared major disasters and emergencies.⁷ In June 2011, the House of Representatives approved a bill that contained an extra \$1 billion for FEMA's Disaster Relief Fund.⁸ At the time, the Disaster Relief Fund was approximately \$2.4 billion.⁹ Although the Disaster Relief Fund appears substantial, this amount may be woefully inadequate in light of recent hurricane-related natural disasters and predictions that natural disasters will increase in the future.

The National Oceanic and Atmospheric Administration (NOAA) predicts increased hurricane activity in upcoming years. NOAA's 2012 Atlantic Hurricane Season Outlook predicts a 35% chance of an above-normal season, a 50% chance of a near-normal season, and a 15% chance of a below-normal season.¹⁰ The Atlantic hurricane region includes the North Atlantic Ocean, the Caribbean Sea, and the Gulf of Mexico. NOAA's outlook was based in part upon three climate factors: (1) the tropical multi-decadal signal, which has contributed to the high-activity era in the Atlantic basin that began in 1995; (2) a continuation of above-average sea-surface temperatures in the tropical Atlantic Ocean and Caribbean Sea; and (3) ENSO-neutral conditions (absence of El Niño or La Niña),¹¹ with lingering La Niña impacts into the summer. NOAA predicted that the conditions expected in 2011 have historically produced some active Atlantic hurricane seasons and that the 2011 hurricane season could see activity

6. *Id.*

7. FED. EMERGENCY MGMT. AGENCY, FISCAL YEAR 2010 BUDGET REQUEST 3 (2009), <http://www.iaem.com/committees/governmentaffairs/documents/FY2010AssociationRolloutSlides.pdf>.

8. Brian Naylor, *New Storms, Prior Disasters Burden FEMA's Budget*, NPR.ORG (June 6, 2011, 12:01 AM), <http://www.npr.org/2011/06/06/136991203/new-storms-prior-disasters-burden-fema-s-budget>.

9. *Id.*

10. NOAA 2012 Atlantic Hurricane Season Outlook Update, CLIMATE PREDICTION CTR. (Aug. 9, 2012), <http://www.cpc.ncep.noaa.gov/products/outlooks/hurricane.shtml>.

11. *El Niño/Southern Oscillation (ENSO)*, NAT'L CLIMATIC DATA CTR., <http://www.ncdc.noaa.gov/teleconnections/enso/index.php> (last visited Dec. 19, 2012) ("El Niño and the Southern Oscillation, also known as ENSO is a periodic fluctuation (i.e., every 2–7 years) in sea surface temperature (El Niño) and the air pressure of the overlying atmosphere (Southern Oscillation) across the equatorial Pacific Ocean. The presence of an El Niño, or its opposite—La Niña—sufficiently modifies the general flow of the atmosphere to affect normal weather conditions in many parts of the world.").

comparable to a number of active seasons since 1995. NOAA estimated a 70% probability for each of the following ranges of activity during 2011: (1) twelve to eighteen named storms; (2) six to ten hurricanes; and (3) three to six major hurricanes.¹² The official seasonal averages are eleven named storms, with six becoming hurricanes, and two of those becoming major hurricanes.¹³ But since 1995, there has been a high activity of hurricanes. Hurricane seasons during 1995 through 2010 have averaged about fifteen named storms, eight hurricanes, and four major hurricanes. NOAA has classified eleven of the sixteen seasons since 1995 as above normal, with eight being extremely active. Only five seasons since 1995 have not been above normal. These include four El Niño years (1997, 2002, 2006, and 2009) and the 2007 season. NOAA's predictions for the 2011 hurricane season are higher than even the average for 1995 through 2010, which is considered a high-activity era. In addition, NOAA believed that several dynamical-model forecasts of the number and strength of tropical cyclones generally predict an above-normal season in 2011 as well.

In fact, there were a total of nineteen named storms during the 2011 Atlantic hurricane season with seven becoming hurricanes.¹⁴ Two hurricanes, Katia and Ophelia, were Category 4 hurricanes, while Hurricane Irene was a Category 3.¹⁵ The 2011 hurricane season was an above-normal season as predicted. Despite the aforementioned continued concerns, NOAA originally predicted that the 2012 Atlantic Hurricane season would be an average season.¹⁶ NOAA predicted that there was a 70% chance of nine to fifteen named storms, of which four to eight would strengthen to a hurricane and of those, one to three would become major hurricanes.¹⁷ NOAA later revised

12. *NOAA 2012 Atlantic Hurricane Season Outlook Update*, *supra* note 10.

13. *Id.*

14. *2011 Atlantic Hurricane Season*, NAT'L WEATHER SERV., <http://www.nhc.noaa.gov/2011atlan.shtml> (last modified May 1, 2012).

15. *Id.*

16. *NOAA Predicts a Near-Normal 2012 Atlantic Season*, NAT'L OCEANIC & ATMOSPHERIC ADMIN. (May 24, 2012), http://www.noaanews.noaa.gov/stories2012/20120524_atlantic_hurricane_season.html.

17. *Id.*

its hurricane outlook for 2012. NOAA's updated 2012 Atlantic Hurricane Season Outlook indicated an 85% chance of a near- or above-normal season.¹⁸ NOAA also indicated that there was a "50% chance of a near-normal season, a 35% chance of an above normal season, and only a 15% chance of a below-normal season."¹⁹ NOAA also estimated a 70% probability that the entire 2012 Atlantic hurricane season would consist of twelve to seventeen named storms, including five to eight hurricanes, of which two to three were expected to become major hurricanes, i.e., Category 3, 4, or 5 with wind speeds at least 111 m.p.h.²⁰ As of the mid-November 2012, there were nineteen named storms, that included ten hurricanes, of which only one was a major hurricane.²¹ The actual hurricanes in the 2012 Atlantic hurricane season exceeded NOAA's predictions, but were not as strong as NOAA predicted.

In the past 32 years, there have been 133 weather-related disasters in the United States where the overall damages or costs reached or exceeded \$1 billion.²² The total normalized losses for the 133 events exceed \$875 billion.²³ The year 2011 represents the highest damage cost-to-date in the United States for any year since 1980 when the National Climatic Data Center (NCDC) began tracking billion-dollar disasters.²⁴ Furthermore, in 2011 there were at least ten \$1 billion disasters that occurred in the United States. Hurricane Irene, which struck August 20–29, 2011, ranked as the third-highest-ranking \$1 billion weather or climate event of the year, with nearly \$10 billion in damages from wind and flood.²⁵ The economic damages from weather/climate events, including tornadoes, droughts, and floods caused by snow melt or rain, in the United States for 2011 ap-

18. NAT'L OCEANIC & ATMOSPHERIC ADMIN., *NOAA 2012 Atlantic Hurricane Season Outlook Update*, NAT'L WEATHER SERV. (Aug. 9, 2012), <http://www.cpc.ncep.noaa.gov/products/outlooks/hurricane.shtml>.

19. *Id.*

20. *Id.*

21. NAT'L OCEANIC & ATMOSPHERIC ADMIN., *Monthly Atlantic Tropical Weather Summary*, NAT'L WEATHER SERV., <http://www.nhc.noaa.gov/text/MIATWSAT.shtml> (last modified Dec. 1, 2012).

22. *Billion Dollar U.S. Weather/Climate Disasters*, NAT'L CLIMATIC DATA CTR., <http://www.ncdc.noaa.gov/billions> (last updated Apr. 26, 2012).

23. *Id.*

24. *Id.*

25. *Id.*

proached nearly \$60 billion.²⁶

Being faced with such devastating major disasters in 2011 and 2012, and the certain possibility of more hurricanes in the coming years, the nation should consider enacting legislation that addresses damages resulting from hurricanes and other major weather phenomena like tornadoes. Otherwise, insurance carriers may withdraw from writing insurance coverage in areas prone to hurricanes or premiums for homeowners and business multi-peril policies in those areas may skyrocket to prohibitive levels. Thus, the first issue is whether the federal government or state governments should enact statutory regulations for the coverage of hurricanes, followed by what shape that regulation should take. This article next addresses how states have tried to tackle such issues by enacting non-cancellations moratoriums.

II. HURRICANE ANDREW AND THE EMERGENCE OF NON-CANCELLATION MORATORIUMS FOR HOMEOWNER COVERAGE

In 1992, Hurricane Andrew caused unprecedented physical, economic, and social damage.²⁷ It was estimated that the storm caused between \$16 and \$18 billion in property damage²⁸ and destroyed more than 60,000 homes, leaving as many as a quarter-million people homeless.²⁹ The insurance companies underestimated the potential destructive force of hurricanes like Hurricane Andrew.³⁰ The monetary losses from Andrew greatly exceeded the value of collected premiums in Florida.³¹ Ten of Florida's insurance companies were essentially bankrupted by Andrew (claims of policyholders exceeded the

26. *Id.*

27. See Larry Rohter, *Supplies Flow in for Stricken Areas, but Delivery Is Slowed by Wreckage*, N.Y. TIMES, Aug. 27, 1992, at B9 (discussing the extent of damages that Hurricane Andrew inflicted).

28. See Act of June 8, 1993, ch. 93-401, 1993 Fla. Laws 2881 § 1 (finding by the Florida Legislature that Hurricane Andrew caused more than \$16 billion of insured loss); Thomas S. Mulligan, *Quake Payout to Be Insurers' 3rd Highest*, L.A. TIMES, Feb. 7, 1994, at 1A (noting the cost of damage, in dollars, for different natural disasters).

29. See Rohter, *supra* note 27 (discussing the extent of damages that Hurricane Andrew inflicted).

30. See *Insurance Companies Retrench in Wake of Disasters*, L.A. TIMES, Sept. 22, 1993, at D9 (noting past insurance-company mistakes).

31. See Christina Sherry, *Florida Homeowners Feel Pinch as Insurance Companies Bail Out*, WASH. POST, June 13, 1993, at A3 (noting that an estimated \$10.8 billion in premiums were collected from Florida homeowners, but \$18 billion were incurred as losses).

capital surplus and reinsurance set aside for the claims).³² Due to the realized risk, insurance companies considered retreating from offering insurance in the coastal regions of hurricane-prone southern Florida.³³ National carriers wrote 94% of the homeowner's business in Florida at the time Hurricane Andrew hit.³⁴ Allstate announced that it would not renew more than 800,000 policies in the area and other carriers announced similar plans to non-renew, cancel, and reduce the number of new policies written.³⁵ Matters worsened because no other carriers were coming forward to issue policies to homeowners abandoned by the fleeing national carriers.³⁶

In the wake of Hurricane Andrew, the Florida Department of Insurance (FDI) promulgated emergency rules that limited the number of permissible cancellations or non-renewals of homeowner insurance policies in the coastal counties of Dade and Broward.³⁷ The FDI issued Emergency Rule 4ER93-18, imposing a six-month moratorium on the non-renewal or cancellation of homeowner's policies due to the risk of hurricane loss.³⁸ Ostensibly, the moratorium

32. See Albert B. Crenshaw, *Insurance Firms Curbing Coverage for Homeowners; Coastal Areas Most Affected by Retrenchment*, WASH. POST, May 8, 1993, at E1 (detailing the financial ramifications for insurance companies caused by Hurricane Andrew). As an example, Prudential Property & Casualty Corp. had a capital base of \$575 million when Andrew struck and eventually paid out claims of more than \$1.3 billion. See David Satterfield, *Prudential Sues to Drop 25,000-Insurer Challenges State's Moratorium*, MIAMI HERALD, June 30, 1993, at A1. Prudential Property & Casualty Corp. was effectively bankrupted by Hurricane Andrew. Were it not for a capital infusion of \$900 million from its parent corporation, Prudential Insurance Co. of America, Prudential Property & Casualty Corp. would have failed, and its policyholders would have been left empty-handed to the tune of more than \$600 million. See *id.*

33. See Phillip Longmore, *The Politics of Wind: How Tallahassee's \$36 Billion Dollar Insurance Scheme Could Blow You Away*, FLA. TREND, Sept. 1994, at 30, 36 (discussing causes of insurance companies' actions).

34. Chad Hemenway, *Florida Insurance Commissioner During Andrew Remembers the Storm—and Assesses Its Game-Changing Impact*, PROPERTY CASUALTY 360 (Aug. 23, 2012), <http://www.propertycasualty360.com/2012/08/23/pc360-exclusive-florida-insurance-commissioner-dur>.

35. *Id.*

36. *Id.*

37. Steven Plitt & Daniel Maldonado, *Prohibiting De Facto Insurance Redlining: Will Hurricane Katrina Draw a Discriminatory Redline in the Gulf Coast Sands Prohibiting Access to Home Ownership?*, 14 WASH. & LEE J. CIVIL RTS. & SOC. JUST. 199, 237 n.254 (2008) (listing sources in Florida's administrative register).

38. See *id.* n.255.

This emergency rule, however, was legally valid for only ninety days. However, the Florida Legislature enacted Ch[apter] 93-401, Laws of Florida, which essentially imposed a six-month moratorium upon the cancellation or non-renewal of homeowner's insurance policies based on the risk of hurricane claims. The preamble to

was FDOI's attempt to temporarily stabilize the residential homeowner's insurance marketplace in the aftermath of Hurricane Andrew. The emergency regulation issued by the FDOI was codified by the Florida Legislature.³⁹ The legislatively enacted moratorium law contained a provision that addressed potential insurance company insolvency.⁴⁰ Under this provision, if the insurance company could affirmatively demonstrate that any proposed cancellation or non-renewal was necessary to avoid the risk of that insolvency it would avoid the cancellation and nonrenewal regulations.⁴¹ In reaching a determination that the insurance company was facing an unreasonable risk of insolvency, the FDOI considered the insurer's size, its market concentration, its general financial condition, the degree to which personal lines residential property insurance comprised its insurance business within the state of Florida, and the way in which those factors impact on the risk of the insurer's insolvency in relationship to its probable maximum loss in the event of a hurricane.⁴² An insurance company, however, was not required to risk more than its total surplus to an objectively defined maximum loss resulting from one Florida hurricane loss event.⁴³

Additionally, the moratorium law had a restricted business phase-out provision.⁴⁴ Under the phase-out provision, an insurance compa-

Ch[apter] 93-401, Laws of Florida, provides as its justification that "the enormous monetary impact to insurers of Hurricane Andrew claims has prompted insurers to propose substantial cancellation or non-renewal of their homeowner's [policies]." In November 1993, when the initial moratorium was scheduled to expire, the Florida Legislature met in a special session and approved a three-year extension, and subsequent phase out of the moratorium.

Id. (citations omitted).

39. *See id.* at 237-38 n.256 ("Ch. 93-401, Section 4, 1993 Fla. Laws 2881. The Florida legislature enacted Chapter 93-401, Laws of Florida, which essentially imposed a six-month moratorium upon the cancellation or non-renewal of homeowner's insurance policies based on the risk of hurricane claims.").

40. 1993 Fla. Laws 2882.

41. *See id.*

42. *See id.*

43. *Id.*

44. *See id.*; *see also* FLA. STAT. § 627.7013 (repealed 2002); 20 Fla. Admin. Weekly 531 (1994). The exception to the phase-out statute has been narrowed by the FDOI's liberal interpretation of the statute so that any reason given by an insurance company for canceling or non-renewing a particular homeowner's policy is deemed to be related to the risk of hurricane loss. As an example, in Proposed Rules 4-141.020(9)(a) and 4-141.021(3)(a)(3), the FDOI asserted that the statutory word "unrelated" must be construed in a "liberal, wide-reaching manner." Consequently, to be exempted from the phase-out statute's moratorium limits, a nonrenewal of a residential policy "must be completely unrelated, directly or indirectly, to reduction of risk of

ny was prohibited from cancelling or non-renewing more than five percent of its homeowners' policies, mobile home owners' policies or personal lines residential policies within the state in any twelve month period, and could not cancel or non-renew more than ten percent of its homeowners' policies, mobile home owners' policies or personal lines residential policies within a given county, to reduce the insurer's exposure to hurricane claims.⁴⁵ Any insurance company seeking to exceed these limits on cancellation or non-renewals within a given year was required to file a phase-out plan with the FDOI and obtain the FDOI's approval before implementing the plan.⁴⁶ At least one insurer, Prudential Property & Casualty Insurance Co. of Indiana, sought administrative exemption from the moratorium law which was denied by the FDOI and which was unsuccessfully appealed in court.⁴⁷

Florida's moratorium legislation had an adverse market consequence.

As of spring 2006, most Florida insurers had stopped writing homeowners coverage, leaving property owners without preexisting coverage with the prospect of purchasing much more expensive coverage through Citizens Property Insurance Corporation, the state-created insurer of last resort, which is now the state's second largest insurer. At the end of the 2005 hurricane season, however, Citizens had accumulated a \$1.7 billion deficit requiring Florida lawmakers to fashion a relief package for the troubled insurer.⁴⁸

The Florida Legislature did provide relief to bolster the property insurance market including \$715 million of general state revenues to

loss from hurricane exposure." *Id.*

45. FLA. STAT. § 627.7013 (repealed 2002).

46. *Id.*

47. See *Prudential v. Dep't of Ins.*, 626 So.2d 994, 999 (Fla. Dist. Ct. App. 1993) ("We conclude that, by virtue of section 120.68(1), Florida Statutes, rule 9.030(b)(1)(C), Florida Rule of Appellate Procedure, and Article V, section 4(b)(2), of the Florida Constitution, we have jurisdiction to review the department's decision in its August 10 letter denying the requested exemption."). Florida had a withdrawal statute before Hurricane Andrew that authorized insurance companies to surrender their Certificates of Authority thereby withdrawing from the state or to withdraw from a specific line of insurance upon giving proper notice. FLA. STAT. § 624.430 (2004). The FDOI construed the phase-out statute as superseding an insurance company's right to surrender its Certificate of Authority and withdraw its business from the state's residential property insurance market. See 20 Fla. Admin. Weekly 531, 534 (1994) (discussing the interpretation of § 627.7013).

48. Robert H. Jerry, II & Steven E. Roberts, *Regulating the Business of Insurance: Federalism in an Age of Difficult Risk*, 41 WAKE FOREST L. REV. 835, 876 (2006).

deal with a portion of Citizens' deficit.⁴⁹ Florida policyholders faced steep rate hikes⁵⁰ based upon insurance carriers' expectations that higher reserves were needed to pay claims due to anticipated increased hurricane activity in the area.⁵¹

The Florida Legislature also created the Florida Hurricane Catastrophe Trust Fund (FHCTF).⁵² The FHCTF is required to "reimburse the insurer for 45%, 75%, or 90% of its losses from each covered event in excess of the insurer's retention, plus 5% of the reimbursed losses to cover loss adjustment expenses."⁵³ Following the overwhelming demand on the FHCTF in 2004 and 2005, Florida revamped its state catastrophic reinsurance program.⁵⁴ Florida House Bill 1A, which became law on January 25, 2007, allowed a temporary opportunity for insurers to increase their premiums for and coverage by the FHCTF.⁵⁵ The Florida Legislature intended "to create a temporary emergency program, applicable to the 2007, 2008, and 2009 hurricane seasons, to address these market disruptions and enable insurers, at their option, to procure additional coverage from the [FHCTF]."⁵⁶

49. *Id.*

50. *Id.* In states vulnerable to hurricanes, rate increases between 30% and 150% have been sought. *Id.* The Mississippi Windstorm Association, insuring Mississippi's hurricane vulnerable coastal areas, was facing a reinsurance rate increase for 2006 of 488%. *Id.*

51. Shaheen Pasha, *More Hurricanes, Higher Insurance Rates?*, CNN MONEY (Sept. 23, 2005), http://money.cnn.com/2005/09/23/news/economy/rita_katrina_insurance/index.htm.

52. See FLA. STAT. § 215.555 (2012). The Florida Hurricane Catastrophe Trust Fund was established by Ch. 93-430, which was codified in section 215.555. See *id.*

53. *Id.* § 215.555(4)(b). The FHCTF is capitalized by a mandatory assessment against all insurers. *Id.* § 215.555(6)(b).

54. *Id.* § 215.555.

55. *Id.*

56. *Id.* The Florida Legislature also considered novel incentive programs. The Florida Legislature adopted a notion of a Hurricane Savings Account for individuals. See Patrick E. Tolan, Jr., *Facts and Insurance Consequences of Major Disasters: Weathering the Storm*, 31 NOVA L. REV. 487, 521 (2007). The Hurricane Savings Account would be available "to cover an insurance deductible or other uninsured portion of the risks of loss from a hurricane, rising flood waters, or other catastrophic wind storm event." *Id.* (quoting FLA. STAT. § 222.22(4)(a)). The benefits of such an account cannot be realized until the federal government creates a tax-exempt or tax-deferred savings vehicle. See FLA. STAT. § 222.22(4)(c). The federal government has not yet created such a favored tax position. Tolan, *supra*, at 521. In 2007, the Florida Legislature passed a House Memorial asking for the creation of a tax-exempt account for taxpayers to accumulate financial reserves on a tax advantage basis for the purpose of paying for mitigation enhancements and catastrophic losses. See Florida H.M. 11A at 3 (2007). The Florida Legislature also requested that Congress create a tax-deferred insurance company catastrophe reserve to benefit policyholders. See *id.*; see H.R. 4836, 109th Cong. (2nd Sess. 2006), cited in Tolan, *supra*, at 521. "These tax-deferred reserves would build up over time and only be eligible to be used to pay for

Other states followed Florida's lead. After Hurricane Katrina, the Louisiana Department of Insurance issued emergency rules precluding insurance companies from cancelling or non-renewing policies solely because the insured submitted a claim as a result of storm damage from Hurricane Katrina.⁵⁷ The states of Mississippi⁵⁸ and Alabama⁵⁹ also enacted moratoriums on cancellations and non-renewals. The non-cancellation and non-renewal moratoriums utilized by Louisiana, Mississippi, and Alabama were less comprehensive than the moratorium initiated by the FDOI. What has emerged is the use of emergency moratoriums to regulate the post-hurricane residential homeowner insurance marketplace.

III. STATES HAVE AUTHORITY TO REGULATE UNDER DUAL

future catastrophic losses." Florida H.M. 11A at 3 (2007).

57. See Emergency Rules 15–17, LA. ADMIN. CODE tit. 37, § 2700 *et seq.* (2005) (mandating compliance with state-imposed procedures to ensure coverage in the wake of Hurricanes Katrina and Rita). On September 19, 2005, Governor Kathleen Babineaux Blanco signed an executive order giving the Commissioner of Insurance the temporary authority to implement certain emergency insurance rules in the wake of Hurricane Katrina and its aftermath. Exec. Order No. KBB 2005–40, § 4. The Commissioner issued Emergency Rules 15, 16, and 17, that included, among other things, that an insurance carrier cannot cancel or non-renew policies for certain affected parishes because of a Hurricane Katrina claim. Louisiana also adopted Emergency Rule 23, which suspended the rights of any admitted insurer or surplus line insurer to cancel or non-renew any personal residential, commercial residential, or commercial property insurance policy that sustained damage as a result of Hurricanes Katrina or Rita until sixty days after substantial completion of the repair and/or reconstruction of the property or December 11, 2006. *Id.*

58. Beginning on September 15, 2005, the Mississippi Insurance Department ("MID"), for example, imposed a moratorium on cancellations because of the failure to pay premiums during the sixty days following August 29, 2005. Bulletin 2005–7. The moratorium was extended for an additional sixty days on October 26, 2005. Bulletin 2005–12. The MID issued a directive on November 4, 2005 limiting cancellations to property damaged by Hurricane Katrina for which repairs have not yet been completed. The directive precluded insurers from canceling or refusing to renew a "personal or commercial residential property policy" covering a dwelling or residential property in Mississippi that has been damaged by Katrina for a period of sixty days after the property has been repaired. Bulletin 2005–13. Bulletin 2005–13 was amended on January 27, 2006 to include cancellations/non-renewals of commercial property.

59. Even before Hurricane Katrina made landfall on August 28, 2005, Alabama had in place a policy prohibiting cancellations and non-renewals of automobile or property insurance policies based solely on claims arising from a catastrophe, natural disaster, act of nature, or weather related cause. ALA. DEP'T OF INS., BULL. PROHIBITED POLICY CANCELLATION AND NONRENEWALS (July 20, 2004). More recently, the Alabama Department of Insurance issued a bulletin on January 3, 2007 requiring written notice to the Commissioner and to the insured of non-renewal of coverage based upon the insurer's desire to reduce its exposure to potential catastrophic events, including but not limited to a hurricane. An insurer's failure to comply with either bulletin is considered an unfair trade practice. ALA. DEP'T OF INS., BULL. NOTICE REQUIREMENTS FOR NON-RENEWAL OF COVERAGE (Jan. 3, 2007).

SOVEREIGNTY

A. Dual Sovereignty Generally

The United States governmental structure is built upon the concept of dual sovereignty.⁶⁰ The federal government concurrently holds sovereignty concurrent with state governments. The only limitation imposed on this shared sovereignty emanates from the Supremacy Clause of the United States Constitution.⁶¹

60. *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991). See Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1491–1511 (1987) (discussing the advantages and disadvantages of the dual sovereignty system); Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 3–10 (1988) (“A dual system of government checks abuses of power in any branch of the system.”).

61. U.S. CONST. art VI, para. 2; see also *P.R. Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc.*, 506 U.S. 139, 146 (1993); *Tafflin v. Levitt*, 493 U.S. 455, 458 (1990) (stating that the central purpose of the sovereign immunity doctrine is to accord the states the respect owed to them as “joint sovereigns”).

Generally, dual sovereignty is recognized by the federal courts through the Federal Abstention Doctrine. There are many types of abstention. Although many concepts can be labeled as part of the Abstention Doctrine, there are four principal variants of the Abstention Doctrine. Each of the variants takes on its namesake from the case adopting that particularized abstention principle.

Pullman Abstention applies “when a federal constitutional claim is premised on an unsettled question of state law, the federal court should stay its hand in order to provide the state courts an opportunity to settle the underlying state-law question and thus avoid the possibility of unnecessarily deciding a constitutional question.” *Orr v. Orr*, 440 U.S. 268, 285 (1979) (Powell, J., dissenting) (quoting *Harris Cnty Comm’rs Court v. Moore*, 420 U.S. 77, 83 (1975); see also *R.R. Comm’n of Tex. v. Pullman Co.*, 312 U.S. 496, 501 (1941)).

Under Burford Abstention, the federal court considers the independence of state governments in carrying out domestic policy, and seeks to avoid conflict between state and federal courts. See *Burford v. Sun Oil Co.*, 319 U.S. 315, 333–34 (1943); *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 727–28 (1996).

Under Younger Abstention, “a federal court should not enjoin a state criminal prosecution begun prior to the institution of the federal suit except in very unusual situations, where necessary to prevent immediate irreparable injury.” *Samuels v. Mackell*, 401 U.S. 66, 69 (1971). See also *Younger v. Harris*, 401 U.S. 37, 56 (1971); *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 816 (1976). In *Colorado River*, the Court tied the variations on abstention (Pullman, Burford, and Younger) together under the broader category of “exceptional circumstances.” *Id.* at 813–17. The Court found that there are “exceptional circumstances” relating to “[w]ise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation,” and that the exceptional circumstances should be weighed against the duty to exercise federal jurisdiction. *Id.* at 817–19 (quoting in part *Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co.*, 342 U.S. 180, 183 (1952)).

There is a separate line of abstention cases that has developed which define the boundaries of discretion in the context of the Federal Declaratory Judgment Act. In *Brillhart v. Excess Insurance Co. of America*, 316 U.S. 491, 495 (1942), the Court gave direction to the lower courts regarding their exercise of discretion to deny jurisdiction in federal declaratory judgment ac-

The Eleventh Amendment was enacted to delineate the scope of sovereign immunity reserved by the states. Under the Eleventh Amendment non-consenting states may not be sued by private individuals in federal court.⁶² States had inherent sovereignty prior to the ratification of the United States Constitution. When the Constitution was ratified they maintained partial sovereignty which was reserved through the Tenth Amendment. The concept of inherent sovereignty does not apply to the federal government, however.⁶³ The federal government is a sovereign of delegated, limited, and enumerated powers.⁶⁴ The powers of Congress are not given by the people of a single state; they are given by the people of the United States to a government whose laws, made in pursuance of the Constitution, are declared to be supreme. Consequently, the people of a single state cannot confer a sovereignty, which will extend over them.⁶⁵

Under the original Articles of Confederation, Congress could only legislate with the approval of the states.⁶⁶ Because of the inadequacy of the federal government to directly legislate, the Constitutional Convention was convened.⁶⁷ Through the ratification process of the Constitution, states retained their sovereign immunity.⁶⁸ A principal focus of the Constitutional Convention was to restructure Congress in order to give Congress the power to legislate without the need of the state legislatures.

As part of this dual system, “States possess sovereignty concurrently with . . . the Federal Government, subject only to limitations imposed by the Supremacy Clause” of the United States Constitu-

tions. The *Brillhart* court found that it would “ordinarily . . . be uneconomical as well as vexatious for a federal court to proceed in a declaratory judgment suit where another suit is pending in a state court presenting the same issues, not governed by federal law, between the same parties.” *Id.* at 491. The *Brillhart* court advised that district courts should assess whether the controversy could better be resolved in the state court proceeding in determining whether to abstain. *Id.*

62. *Bd. of Trs. of the Univ. of Ala. v. Garrett*, 531 U.S. 356, 363 (2001).

63. *Perry v. United States*, 294 U.S. 330, 335 (1935).

64. *United States v. Harris*, 106 U.S. 629, 635 (1883).

65. *Kansas v. Colorado*, 206 U.S. 46, 69–70 (1907).

66. *See New York v. United States*, 505 U.S. 144, 163 (1992) (“Congress could not directly tax or legislate upon individuals; it had no explicit ‘legislative’ or ‘governmental’ power to make binding ‘law’ enforceable as such.” (quoting Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 *YALE L.J.* 1425, 1447 (1987))).

67. *Id.*

68. *Alden v. Maine*, 527 U.S. 706, 755–56 (1999).

tion.⁶⁹ When the states ratified the Constitution, the states retained their sovereign authority.⁷⁰

B. The Battle for Jurisdiction over the Insurance Industry

Under dual sovereignty, a question arose over which sovereign, the states or the federal government, should regulate the business of insurance. The insurance industry wanted loose federal regulation to control insurance companies.⁷¹ States saw the ability to regulate the business of insurance as a significant revenue source.⁷² As a result, there had been a historical tension between the insurance industry and state regulators.⁷³

One of the most significant challenges to state regulation was through the Commerce Clause of the United States Constitution. This challenge sought to replace state regulation with a less rigorous federal regulatory scheme.⁷⁴ But the commerce clause was found to be inapplicable by the Supreme Court in *Paul v. Virginia*⁷⁵ when the Court found that the business of insurance was not conducted in interstate commerce. The ruling in *Paul v. Virginia* did not dissuade the insurance industry. The insurance industry continued in its attempts to invalidate state insurance laws through the portal of the commerce clause following the *Paul* decision. Numerous Commerce Clause challenges were brought before the United States Supreme Court between 1869 and 1927 where state law regulation was upheld.⁷⁶

69. *Tafflin v. Levitt*, 493 U.S. 455, 458 (1990).

70. *Alden*, 527 U.S. at 755–56.

71. Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 631 (1999).

72. *Id.* at 633.

73. *Id.* at 626 (discussing the inherent tension between state and federal regulation and the arguments supporting both).

74. Davis J. Howard, *Uncle Sam v. The Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 WILLAMETTE L. REV. 1, 22 (1989).

75. 75 U.S. 168, 183 (1869). *See also* Peter H. Nehemkis, Jr., *Paul v. Virginia*, 27 GA. L.J. 518, 525–26 (1939).

76. *See* *Bothwell v. Buckbee-Mears*, 275 U.S. 274 (1927) (holding that it was appropriate to deny foreign insurer access to state court where foreign insurer was not qualified to transact business in the state court); *Nw. Mut. Life Ins. Co. v. Wisconsin*, 247 U.S. 132 (1918) (upholding state statute taxing gross income of insurance companies); *N.Y. Life Ins. Co. v. Deer Lodge Cnty.*, 231 U.S. 495 (1913) (upholding state statute taxing foreign insurers doing business in the state on the difference between premiums received and losses and ordinary expenses related to business transacted within state); *Nutting v. Massachusetts*, 183 U.S. 553 (1902) (upholding state statute prohibiting the soliciting of insurance business within the state on behalf of unli-

Congress had previously enacted sweeping antitrust legislation through the Clayton Act,⁷⁷ the Sherman Act,⁷⁸ and the Federal Trade Commission Act.⁷⁹ Following the *Paul* decision, a debate then arose as to whether federal antitrust law or weak state insurance laws should govern monopolistic behavior within the insurance industry. The expansion of federal antitrust law and federal regulations over interstate commerce resulted in the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n*⁸⁰ where the court held that "[n]o commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the commerce clause. We cannot make an exception of the business of insurance."⁸¹ Prior to the *South-Eastern Underwriters* decision, the "regulation of insurance transactions was thought to rest exclusively with the States,"⁸² and "the States enjoyed a virtually exclusive domain over the insurance industry."⁸³

C. State Jurisdiction Prevails

The McCarran-Ferguson Act⁸⁴ was enacted as a direct response

censed foreign insurer); *N.Y. Life Ins. Co. v. Cravens*, 178 U.S. 389 (1900) (upholding state statute protecting life insurance companies from forfeiture for failure to pay premiums applied to foreign insurer which issued a policy to state resident); *Noble v. Mitchell*, 164 U.S. 367 (1896) (upholding statute holding agents of unlicensed foreign insurers personally liable on policies sold); *Hooper v. California*, 155 U.S. 648 (1895) (upholding statute requiring agent of foreign insurer to post a bond); *Fire Ass'n of Phila. v. New York*, 119 U.S. 110 (1886) (upholding New York retaliatory tax on foreign insurance company); *Liverpool Ins. Co. v. Massachusetts*, 77 U.S. 566 (1870) (upholding state tax on insurance companies incorporated abroad); *Ducat v. Chicago*, 77 U.S. 410 (1870) (upholding municipal tax on insurance premiums earned by foreign insurance companies).

77. 15 U.S.C. §§ 12–27 (2012).

78. *Id.* §§ 1–11.

79. *Id.* §§ 41–58.

80. 322 U.S. 533 (1944).

81. *Id.* at 553. *See also* *Robertson v. California*, 328 U.S. 440 (1946); and *First Nat'l Benefit Soc'y v. Garrison*, 58 F. Supp. 972 (S.D. Cal. 1945), *aff'd per curiam without opinion* 155 F.2d 522 (9th Cir. 1946), which were decided after *South-Eastern Underwriters Ass'n* but before the McCarran-Ferguson Act took effect. Both *Garrison* and *Robertson* conformed with Justice Black's statement in *South-Eastern Underwriters Ass'n* that unless Congress preempted the states from legislating in the same area, state power over the insurance industry would not be circumscribed.

82. *Sec. Exch. Comm'n v. Nat'l Sec. Inc.*, 393 U.S. 453, 458 (1969).

83. *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 539 (1978).

84. McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011–1015 (2012)).

to the *South-Eastern Underwriters Ass'n* decision.⁸⁵ Through the Act, Congress declared “that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.”⁸⁶ Congress also confirmed that “[n]o act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance.”⁸⁷ The purpose of the congressional enactment was “to restore the supremacy of the States in the realm of insurance regulation,”⁸⁸ and “remove all Commerce Clause limitations on the authority of the States to regulate and tax the business of insurance.”⁸⁹

The constitutionality of the McCarran-Ferguson Act was re-

85. Immediately following the *South-Eastern Underwriters Ass'n* decision, there were three sessions of Congress considering legislation to reverse the decision before the McCarran-Ferguson Act was adopted. See *An Act to Express the Intent of the Congress with Reference to the Regulation of the Business of Insurance*, ch. 20, 59 STAT. 33 (1945).

86. 15 U.S.C. § 1011. The McCarran-Ferguson Act has been viewed by some courts and commentators as the codification of the state action doctrine within the area of insurance. See *Hoover v. Ronwin*, 466 U.S. 558 (1984); *Wash. State Elec. Contractors Ass'n v. Forrest*, 839 F.2d 547 (9th Cir. 1988); Thomas M. Jorde, *Antitrust and the New State Action Doctrine: A Return to Differential Economic Federalism*, 75 CAL. L. REV. 227 (1987). The state-action doctrine was used by insurance companies when McCarran's antitrust exemption was narrowed by the courts. See Robert W. Hammesfahr, *Antitrust Exemptions Applicable to the Business of Insurance Other than the McCarran-Ferguson Act: The State Action Exemption and the Noerr-Pennington Doctrine*, 54 ANTITRUST L.J. 1321 (1985). More recently the state-action doctrine has been circumscribed. See Leslie W. Jacobs, *State Regulation and the Antitrust Laws*, 25 CASE W. RES. L. REV. 221, 231-49 (1975).

87. 15 U.S.C. § 1012(b).

88. *Barnett Bank of Marion Cnty. NA v. Nelson*, 517 U.S. 25, 40 (1996) (quoting *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 500 (1993)). For example, in the Congressional record Senator Revercomb states “the very purpose of [the Act] is to restore the control of the insurance business to the States.” 91 CONG. REC. 462, 485 (1945). Senator Revercomb also stated “we want the business left in the control of the States, unless by enactment in the future we specifically state that we do not want something they are doing to be continued.” *Id.* Senator Ellender stated: “I think all of us agree that the States should retain the right of regulating and taxing the insurance business within their respective borders.” *Id.* at 487. Congressman Gwynn described the purpose of the Act as follows: “[w]hat we are trying to do is to make it clear to the States and to the insurance companies that we are as far as possible removing ourselves from the field.” 91 CONG. REC. 1081, 1090 (1945). Congressman Gwynn emphasized that “in this Bill we are making it clear that we do not move into the field [of insurance regulation].” *Id.* at 1091. Congressman Springer observed that the Act was “preserving to the several States their rights to control and regulate the insurance business within such states . . . all without [Federal] Governmental interference.” *Id.* at 1092.

89. *W. & S. Life Ins. Co. v. Bd. of Equalization*, 451 U.S. 648, 653 (1981).

solved in *Prudential Insurance Co. v. Benjamin*⁹⁰ where the Supreme Court held that states could constitutionally regulate interstate insurance transactions provided that there did not exist contradictory federal legislation related to the business of insurance.⁹¹ In order to bar the application of federal law (excluding federal anti-trust law), three conditions must be present: (1) the federal statute at issue must be a “general” statute that does not “specifically relat[e] to the business of insurance”⁹²; (2) the state statute at issue must be “enacted for the purpose of regulating the business of insurance”⁹³; and (3) the application of the federal statute must “invalidate, impair, or supersede” the state statute.⁹⁴ The court further explained these requirements: “The process of deciding what is and is not the ‘business of insurance’ is inherently a case-by-case problem.”⁹⁵ In order to determine whether a state statute regulates the “business of insurance,” courts must analyze the purpose of the state statute.⁹⁶ In making this determination, courts focus on “the relationship between the insurance company and the policyholder.”⁹⁷ State laws that protect or regulate

90. *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946).

91. *Id.* at 430–31.

92. *Fabe*, 508 U.S. at 501.

93. *Id.* at 508.

94. *Id.* at 500. Before *Fabe*, some courts had used a four-part test. *See, e.g., Cochran v. Paco, Inc.*, 606 F.2d 460, 467 (5th Cir. 1979). The fourth part of the test focused on whether the alleged activities were within the business of insurance.

Several courts of appeal have applied federal laws to the business of insurance where the application of federal law to a particular insurance transaction is not in “direct conflict” with applicable state insurance statutes. Under the “direct conflict” test, the application of general federal laws to “the business of insurance” is permitted when state and federal laws do not conflict. The “direct conflict” test was first enunciated in *NAACP v. American Family Mutual Insurance Co.*, 978 F.2d 287 (7th Cir. 1992). The First, Third, and Ninth Circuits have followed the *American Family Mutual* analysis. *See Sabo v. Metro. Life Ins. Co.*, 137 F.3d 185, 194 (3d Cir. 1998); *Forsythe v. Humana, Inc.*, 114 F.3d 1467 (9th Cir. 1997); *Villafane-Neriz v. FDIC*, 75 F.3d 727 (1st Cir. 1996); *Merchants Home Delivery Serv., v. Frank B. Hall & Co.*, 50 F.3d 1486 (9th Cir. 1995). The Fourth and Sixth Circuits have rejected the direct-conflict test. *See Ambrose v. Blue Cross & Blue Shield*, 95 F.3d 41 (4th Cir. 1996), *aff’d* 891 F. Supp. 1153 (E.D. Va. 1995); *Kenty v. Bank One*, 92 F.3d 384 (6th Cir. 1996). The Eighth Circuit uses a degree-of-impairment analysis. *See Doe v. Norwest Bank Minn. NA*, 107 F.3d 1297 (8th Cir. 1997); *Murff v. Prof'l Med. Ins. Co.*, 97 F.3d 289 (8th Cir. 1996).

95. *Grp. Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 252 (1979) (Brennan, J., dissenting); *see also Prudential Ins. Co.*, 328 U.S. at 416–17 n.15 (1946) (adopting a broad definition of “business of insurance” by concluding that the “business of insurance” included everything from the issuance of an insurance policy to the payment of an insurance claim).

96. *See Sec. Exch. Comm'n v. Nat'l Secs., Inc.*, 393 U.S. 453, 460 (1969).

97. *Id.*

the insurer-insured relationship regulate the “business of insurance.”⁹⁸ But a distinction must be drawn between the business of insurance and the business of insurance companies.⁹⁹

In *Group Life & Health Insurance Co., Inc. v. Royal Drug Co.* the Court created a tripartite test for whether a particular transaction fell within the parameters of the “business of insurance.”¹⁰⁰ In order to be in the “business of insurance,” the transaction must involve the transfer, spreading, and underwriting of a policyholder’s risk;¹⁰¹ the transaction must directly involve the relationship between the policyholder and the insurance company;¹⁰² and the transaction must involve only parties who are part of the insurance industry.¹⁰³ But the three criteria set forth in *Royal Drug Co.* are not necessarily determinative.¹⁰⁴ Each transaction must be analyzed with respect to all three criteria in order to conclude whether it falls within the “business of insurance.”¹⁰⁵ The “business of insurance” is not solely restricted to the writing of insurance contracts.¹⁰⁶ Instead, the analysis focuses on the performance of the insurance policy.¹⁰⁷

98. *See id.*

99. *Id.* at 459–60 (“Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the ‘business of insurance’ does the statute apply.”). In *Royal Drug Co.*, the Supreme Court explained the distinction between a so-called first-clause McCarran-Ferguson case and a so-called second-clause McCarran-Ferguson case. Congress intended the first clause of § 2(b) of the Act to further its primary purpose: preserving state regulation of insurance companies. 440 U.S. at 218 n.18 (“There is no question that the *primary* purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies.”). The second clause of § 2(b) addressed Congress’ secondary goal: granting insurance companies a limited exception from antitrust laws. *Id.* (“The question in the present case, however, is one under the quite different *secondary* purpose of the McCarran-Ferguson Act—to give insurance companies only a limited exemption from the antitrust laws.”). Commentators have observed that the Act may create a two-tiered definitional approach to the phrase “business of insurance.” *See, e.g.,* Robert P. Rothman, Note, *The Definition of “Business Of Insurance” Under The McCarran-Ferguson Act After Royal Globe*, 80 COLUM. L. REV. 1475 (1980). But see Justice Kennedy’s dissent in *U.S. Department of the Treasury v. Fabe*, 508 U.S. 491, 515 (1993) (Kennedy, J., dissenting), where he noted that the maxim of statutory construction that “identical words used in different parts of the Act are intended to have the same meaning” prevents different meanings of the phrase “business of insurance” throughout 15 U.S.C. § 1012(b).

100. *Royal Drug Co.*, 440 U.S. at 211–16, 231–33.

101. *Id.* at 211.

102. *See id.* at 211–15.

103. *Id.* at 211.

104. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982).

105. *Id.*

106. *U.S. Dep’t of Treasury v. Fabe*, 508 U.S. 491, 503 (1993).

107. *Id.* at 503–04. The *Royal Drug Co.* criteria necessarily include policy performance. *Id.*

Consequently, state jurisdiction over insurance regulation prevails. Nevertheless, Congress can still enact federal legislation that specifically applies to the “business of insurance.” In keeping with the states’ jurisdiction over insurance regulation, individual states enacted myriad legislation to address perceived state-specific issues.¹⁰⁸ As discussed in the next section, in the 1990s, some states tackled the insurance issues resulting from the devastating effects of Hurricane Andrew and other hurricanes by enacting non-cancellation moratoriums.

IV. POSSIBLE CONSTITUTIONAL CHALLENGES TO STATE-IMPOSED HURRICANE-EMERGENCY MORATORIUMS

Under the McCarran-Ferguson Act, states have the authority to adopt emergency moratoriums. Insurance companies seeking to withdraw, in whole or in part, from a state that had enacted a moratorium may seek to do so by challenging whether the moratorium is constitutionally permissible. If constitutional challenges are successful, then insureds in hurricane-prone states may be faced without fewer insurance carriers willing to provide insurance or carriers that will do so only at significantly higher and possibly prohibitive rates.

A constitutional challenge to state moratorium statutes must be filed within that state’s court system. It is well established that a “State is immune from suits brought in federal courts by [its] own citizens as well as by citizens of another State.”¹⁰⁹ The Eleventh Amendment to the United States Constitution provides states sovereign immunity from suit in federal court. This immunity extends to state agencies and other governmental entities that are characterized

at 504. The Court observed:

Without performance of the terms of the insurance policy, there is no risk transfer at all. Moreover, performance of an insurance contract also satisfies the remaining prongs of the *Pireno* test: It is central to the policy relationship between insurer and insured and is confined entirely to entities within the insurance industry.

Id. The dissent, however, viewed the majority’s focus on the performance of the insurance contract as being too broad, because any law that affects policyholder benefits would necessarily be a law enacted to regulate the business of insurance. *Id.* at 511 (Kennedy, J., dissenting).

108. See, e.g., Charles R. McGuire, *Regulation of the Insurance Industry After Hartford Fire Insurance v. California: The McCarran-Ferguson Act and Antitrust Policies*, 25 LOY. U. CHI. L.J. 303, 304–05 (1994).

109. *Edelman v. Jordan*, 415 U.S. 651, 663 (1974); see also *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62, 72–73 (2000).

as “arms of the state.”¹¹⁰ The Eleventh Amendment was enacted to clarify the scope of a state’s sovereign immunity as not authorizing suits against states.¹¹¹ “The ultimate guarantee of the Eleventh Amendment is that non-consenting States may not be sued by private individuals in federal court.”¹¹²

One of the fundamental understandings behind diversity of citizenship jurisdiction in federal court is that citizens foreign to a particular state may encounter judicial bias in that state’s court system. Removal to federal court can be an important mechanism in preserving fairness against actualized state oriented bias. Unless a state agrees to be sued in federal court by waiving Eleventh Amendment immunity, any insurance company challenge to state moratorium statutes will need to be brought within that state’s court system. Insurance companies will likely face judicial bias in favor of state sequester.¹¹³ This bias will be further incentivized in states where judges are elected.¹¹⁴

A. Takings Clause Challenges

The Takings Clause of the Fifth Amendment provides, in relevant part: “[N]or shall private property be taken for public use, without just compensation.”¹¹⁵ “The Fifth Amendment’s guarantee that pri-

110. See *Freeman v. Oakland Unified Sch. Dist.*, 179 F.3d 846, 846 (9th Cir. 1999) (“The School District is a state agency for purposes of the Eleventh Amendment.”).

111. See *Alden v. Maine*, 527 U.S. 706, 722–23 (1999).

112. *Bd. of Trs. of Univ. of Ala. v. Garrett*, 531 U.S. 356, 363 (2001).

113. Cf. *Brillhart v. Excess Ins. Co.*, 316 U.S. 491, 501–02 (1942) (Stone, C.J., dissenting) (“One of the chief purposes of creating the diversity of citizenship jurisdiction was to afford suitors an unclouded opportunity to assert their rights in the federal courts when the exigencies of state court jurisdiction of subject matter or parties, or both together . . . render doubtful their ability to proceed in the state courts.”).

114. See, e.g., *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868 (2009); Billy Corriher, *Big Business Taking over State Supreme Courts: How Campaign Contributions to Judges Tip the Scales Against Individuals*, CTR. FOR AM. PROGRESS (Aug. 13, 2012), <http://www.americanprogress.org/issues/civil-liberties/report/2012/08/13/11974/big-business-taking-over-state-supreme-courts/>.

115. U.S. CONST. amend. V. The Takings Clause has been applied to physical invasions of property. See *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015 (1992) (noting that the Takings Clause requires compensation for “regulations that compel the property owner to suffer a physical ‘invasion’ of his property”); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 434, 436 (1982) (“When ‘the character of the governmental action’ is a permanent physical occupation of property, our cases have uniformly found a taking to the extent of the occupation,” and “[s]uch an occupation is qualitatively more severe than a regulation of the use of property.” (citations omitted)). Certain types of invasions of private property have been deemed

vate property shall not be taken for a public use without just compensation was designed to bar [the] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”¹¹⁶ The Fifth Amendment applies to state governmental action through the Fourteenth Amendment.¹¹⁷ An insurance contract can constitute property subject to an unconstitutional taking under the Fifth Amendment.¹¹⁸

Insurance companies may have constitutional challenges to the moratorium statutes or regulations enacted by the Gulf states in the aftermath of hurricanes as being “facially”¹¹⁹ unconstitutional or unconstitutional “as applied.”¹²⁰ Central to this argument is the assertion that the insurance company will sustain substantial financial loss as a result of any prohibition on withdrawal from the Gulf states. In-

to be a “*per se* taking” without regard to the state’s interest in possessing or otherwise using the property itself. *See, e.g.,* *New Port Largo, Inc. v. Monroe Cnty.*, 95 F.3d 1084, 1089 (11th Cir. 1996) (“In addition to physical invasions of property, the Supreme Court has also accorded ‘categorical [per se] treatment,’ invariably requiring compensation, to cases ‘where regulation denies all economically beneficial or productive use of land.’” (quoting *Lucas*, 505 U.S. at 1015)). For example, when any statute effectuates an actual government takeover of a private insurance company, a *per-se* taking can occur. *Id.*; *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) (“The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.”). Regulations that disregard or destroy an insurance company’s right to cancel an insurance contract do not automatically transform that regulation into a taking in violation of the Fifth Amendment. *See, e.g.,* *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 224 (1986) (holding that the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking). The factors that must be considered in determining whether a regulatory taking exists are: (1) the economic impact that the challenged rule, regulation, or statute has on the insurer; (2) the extent to which the regulation interferes with investment-backed expectations; and (3) the nature of the challenged action. *See Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 123–25 (1978) (determining whether government conduct constitutes a taking requires that the court engage in an ad hoc, factual inquiry); *see also Hodel v. Va. Surface Mining & Reclamation Ass’n*, 452 U.S. 264, 295 (1981) (“These ‘ad hoc, factual inquiries’ must be conducted with respect to specific property, and the particular estimates of economic impact and ultimate valuation relevant in the unique circumstances.”); *Agins v. City of Tiburon*, 447 U.S. 255, 259–61 (1980) (discussing whether zoning ordinances on their face violated the Takings Clause).

116. *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

117. *See Penn Cent. Transp. Co.*, 438 U.S. at 121–23 (holding that the Takings Clause also applies to the states).

118. *See Lynch v. United States*, 292 U.S. 571, 579 (1934) (valid contracts are property).

119. *See Suitum v. Tahoe Reg’l Planning Agency*, 520 U.S. 725 (1997) (entertaining a landowner’s facial challenge to a local redevelopment plan); *see also Anderson v. Edwards*, 514 U.S. 143 (1995) (entertaining a facial challenge to a state regulation restructuring the disbursement of welfare benefits).

120. *See Penn Cent. Transp. Co.*, 438 U.S. at 127 (discussing whether any restriction imposed on individual landmarks pursuant to the regulation is a taking).

insurance companies can also argue that any statutory or regulatory scheme which precludes an insurance company from allocating the company's resources as it sees fit, forcing it to suffer net economic losses both within and outside the Gulf states, results in a taking of its "property" without just compensation in violation of the Fifth Amendment. In order to make this argument work, the insurance company must show that it was denied all beneficial use of "property."¹²¹ Any showing that beneficial use has been denied will fail because any "compelled" insurance contract would still belong to the insurer and policyholders would still pay the insurance company all required premiums.

This argument takes on more significance where the basis for the policy cancellation is the failure to pay premiums. As an example, the Mississippi Insurance Department, in its emergency regulations, imposed a moratorium on cancellations because of the failure to pay premiums during the sixty days following Hurricane Katrina.¹²² This moratorium on cancellations for failure to pay premiums was extended an additional sixty days.¹²³

The insurance company will need to establish specific economic losses in the hurricane-affected markets as a result of any imposed state moratorium. This would require the insurance company to provide evidence that its rates of return in the hurricane-affected market since the moratorium was imposed have resulted in an unreasonable return. The insurance company could argue that its applications for rate increases have been denied (assuming there is evidence of that fact) and that any potential for future rate increases would not alleviate the insurance company's ongoing economic loss.

Another challenge to the moratorium legislation would be to argue that the moratorium statute interferes with the insurance company's reasonable investment-backed expectations. Interference with investment-backed expectations occurs when an earlier regulation does not provide companies with sufficient notice that they may be subject to new or additional regulation.¹²⁴ Where the statutory or regulatory scheme has previously been amended, however, courts have found that a company is on notice that the legislation may be amended in the future and that there will be additional financial obli-

121. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015 (1992).

122. *Bulletin 2005-7*, *supra* note 58.

123. *Bulletin 2005-12*, *supra* note 58.

124. *See Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 226-28 (1986).

gations.¹²⁵

The compulsory nature of the moratoriums alone is insufficient to establish a Taking Clause violation because all government regulation is compulsory by nature.¹²⁶ The critical factor in determining whether a violative “taking” has occurred is the nature of the state’s interest.¹²⁷ It is less likely that a violative “taking” has occurred when the legislation in question serves important public interests.¹²⁸ The

125. See *id.* at 227 (“Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.” (quoting *Fed. Hous. Admin. v. Darlington, Inc.*, 358 U.S. 84, 91 (1958))). Because the Florida moratorium requires insurers to continue doing business in the market, there may be additional opportunity to argue a Takings Clause violation. This type of argument is supported by the Supreme Court’s decision in *Yee v. City of Escondido*, 503 U.S. 519 (1992). In *Yee*, mobile home park owners filed suit against a municipality alleging that a local rent control ordinance amounted to a taking under the Fifth Amendment and therefore entitled the mobile home owners to just compensation. The court rejected this argument finding that the municipal ordinance did not compel landlords to rent their mobile homes; instead, landlords were free to evict their tenants. *Id.* at 527–28. The Supreme Court noted, however, that “[a] different case would be presented were the statute, on its face or as applied, to compel a landowner over objection to rent his property or to refrain in perpetuity from terminating a tenancy.” *Id.* at 528; see also *People ex rel. Lewis v. Safeco Ins. Co. of Am.*, 414 N.Y.S.2d 823, 826 (N.Y. Sup. Ct. 1978) (“[T]his law expressly requires that . . . insurance companies, like the defendants, renew automobile insurance policies and, accordingly, it warrants careful review.”). “While [a state’s] police power may limit and restrict the uses to which an owner may put his property, it may not compel him to use such property for a particular purpose if he prefers to abandon such a use thereof.” *Dep’t of Pub. Works v. City of San Diego*, 10 P.2d 102, 105 (Cal. Ct. App. 1932). Moratoriums interfere with the investment-backed expectations of insurance companies because they compel them to continue business in a market against their wishes. See *Lewis*, 414 N.Y.S.2d at 830–31 (finding that insurers could not be denied permission to give up writing all of their lines of insurance after sustaining continuing losses writing automobile insurance); *Brooks-Scanlon Co. v. R.R. Comm’n of La.*, 251 U.S. 396, 399 (1920) (“A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage.”). This argument may fail if the state can show that the insurance company is a provider of a vital public service. A state may constitutionally require, however, that a provider of a vital public service provide that service to a part of its market even though it is not profitable for the business. See *Cont’l Air Lines, Inc. v. Dole*, 784 F.2d 1245, 1251–52 (5th Cir. 1986) (finding that an airline may be compelled to operate one small route at a loss for a limited period of time); *Sheeran v. Nationwide Mut. Ins. Co.*, 404 A.2d 625, 629 (N.J. 1979) (sustaining the constitutionality of legislation that compelled automobile insurers to renew policies because the statute reflected “a clear legislative intent that companies which choose to write automobile policies in this state maintain their fair share of coverage.”).

126. See *Connolly*, 475 U.S. at 223. (“[I]t cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.”).

127. See *id.*

128. See *Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 485 (1987) (stating that governmental action is less likely to be perceived as a taking when the government acts within the public’s interest).

general regulation of insurance is within state police powers.¹²⁹ Moratoriums like that imposed after Hurricane Andrew appear to have been intended to stabilize the homeowner marketplace, which would fall within the state's police power.¹³⁰ Within the framework of those powers a state may enact a moratorium for the specific purposes of preventing insurance redlining in the hurricane-affected areas. Clearly, an important public interest mandated by the Fourteenth Amendment is the prevention of discrimination.

Insurers who withdraw from a state or who have refused to issue insurance in specific hurricane-prone areas of the state have been accused of engaging in redlining.¹³¹ States have enacted moratoriums, in part, because of concerns of redlining.¹³² Redlining¹³³ and other

129. See 15 U.S.C. § 1012 (2012) ("The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."); *Cal. State Auto. Ins. Ass'n v. Maloney*, 341 U.S. 105, 109–10 (1951) (stating that the legislature's broad discretion in adopting police power regulations to promote the public welfare "is peculiarly apt when the business of insurance is involved—a business to which the government has long had a 'special relation.'"); *Sheeran v. Nationwide Mut. Ins. Co.*, 404 A.2d 625, 630–31 (N.J. 1979) ("It is well established that the insurance business is strongly affected with a public interest and therefore properly subject to comprehensive regulation in protecting the public welfare."). One leading treatise has described the state's power as follows:

A state has the unquestioned power to regulate insurance companies and the method of conducting that kind of business. The business of insurance is considered not to be merely a private right, but a matter of public concern—a franchise subject to regulation by the state for the public good. And in such regulation, the legislatures are considered to have large powers and wide discretion.

19 JOHN ALAN APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 10321 (1982).

130. See *Vesta Fire Ins. Corp. v. Florida*, 141 F.3d 1427, 1433 (11th Cir. 1998) (noting a moratorium imposed after Hurricane Andrew was within the state's police power).

131. See, e.g., *Florida Says Prudential Unit Redlines*, N.Y. TIMES, Dec. 3, 1992, at D4.

132. *Id.*

133. Redlining is a discriminatory practice that prohibits certain individuals from acquiring property. See *Halprin v. Prairie Single Family Homes of Dearborn Park Ass'n*, 388 F.3d 327, 328–29 (7th Cir. 2004) (defining "redlining" as the practice of denying the extension of credit to specific geographic areas based upon the income, race, or ethnicity of its residents); *Honorable v. Easy Life Real Estate Sys.*, 100 F. Supp. 2d 885, 892 (N.D. Ill. 2000) ("Redlining is the practice of denying the extension of credit to specific geographic areas due to the income, race, or ethnicity of its residents."). In its traditional sense, redlining has been described as "credit discrimination based on the characteristics of the neighborhood surrounding the borrower's dwelling." *Conference of Fed. Sav. & Loan Ass'n v. Stein*, 604 F.2d 1256, 1258 (9th Cir. 1979). "A neighborhood becomes redlined when a lending institution presumes the area is no longer economically stable because of age, racial composition or other characteristics." Edward W. Larkin, Note, *Redlining: Remedies for Victims of Urban Disinvestment*, 5 FORDHAM URB. L.J. 83, 83–84 (1977). Redlining can have a devastating effect because the presumption becomes a self-fulfilling prophecy. See David I. Badain, *Insurance Redlining and the Future of the Urban Core*, 16 COLUM. J.L. & SOC. PROBS. 1, 5–6 (1981) (describing the "cycle of disinvestment" that occurred in urban areas as a result of suburban out-migration). Insurance redlining impairs the ability of

similar discriminatory practices are restricted by state insurance statutes which regulate differences in rates,¹³⁴ premiums,¹³⁵ coverage,¹³⁶ services or benefits under the policy,¹³⁷ rejection of an application for a policy,¹³⁸ refusal to issue or renew a policy,¹³⁹ and so forth. Additionally, state statutes may prohibit discrimination based on various classifications including race, color, creed, marital status, sex and national origin.¹⁴⁰ Thus, the state may have a rational basis supporting its regulatory action.¹⁴¹

individuals of a protected class to acquire property because procuring insurance is a prerequisite to obtaining a mortgage. See, e.g., Dana L. Kaersvang, Note, *The Fair Housing Act and Disparate Impact in Homeowners Insurance*, 104 MICH. L. REV. 1993, 1995 (2006) (“The unavailability of homeowners insurance in black neighborhoods contributes to the gap in homeownership rates.”).

Insurance redlining is the “outright refusal of an insurance company . . . to provide services solely on the basis of a property’s geographical location.” Badain, *supra*, at 4. Where minorities are denied access to a voluntary market, many individuals in the inner city or demographic target are treated as second-class consumers who pay more for less insurance coverage than their suburban non-target counterparts. See *Dunn v. Midwestern Indem. Mid-Am. Fire & Cas. Co.*, 472 F. Supp. 1106, 1111 (S.D. Ohio 1979) (discussing a similar argument made by the Department of Housing of Urban Development in 1978). The effect of insurance redlining is that investment in redlined areas is limited or stopped. The lack of investment results in a diminished growth, repair and sale of housing due to a lack of funding. This is commonly called disinvestment. See Marianne M. Jennings, *Preemption and State Anti-Redlining Regulations: The Need for Clarification*, 11 FORDHAM URB. L.J. 225, 227 n.6 (1983) (explaining the distinction between redlining and disinvestment). The unavailability of property insurance effectively precludes maintenance and improvement of property. Redlining of a neighborhood or geographical area almost guarantees that there will be resulting economic decline. Redlining and disinvestment spread ghettos. See Badain, *supra*, at 34–37 (advocating solutions to counter the effects of insurance redlining). Badain lays the blame for the decline of in-city neighborhoods in part at the feet of insurance companies. *Id.* at 36.

134. See CAL. INS. CODE §§ 10140–10145.4 (West 2006 & Supp. 2012); CONN. GEN. STAT. ANN. § 38a-488 (West 2012); MASS. GEN. LAWS ANN. ch. 175, § 120 (West 2011); N.Y. INS. LAW § 2606(a)(1) (McKinney 2008); OR. REV. STAT. § 737.310 (2011).

135. See CAL. INS. CODE §§ 10140–10145.4; CONN. GEN. STAT. ANN. § 38a-488; MASS. GEN. LAWS ANN. ch. 175, § 120; N.Y. INS. LAW § 2606(a)(1); S.C. CODE ANN. § 38-55-50 (2007).

136. See, e.g., CAL. INS. CODE §§ 10140–10145.4.

137. See, e.g., *id.*

138. See *id.*; N.Y. INS. LAW § 2606(b)(1).

139. See CAL. INS. CODE §§ 675–679.7; N.Y. INS. LAW § 2606(b)(2).

140. See ARIZ. REV. STAT. ANN. § 20–1548(B) (West 2008); KAN. STAT. ANN. § 40-3510(a) (West 2007) (same); MICH. COMP. LAWS ANN. § 500.2027 (West 2012).

141. Some commentators believe that “[t]he unavailability of insurance coverage stemming from redlining has contributed to the deterioration of American urban centers and has effectively frustrated attempts at urban revitalization.” Kevin J. Byrne, Comment, *Application of Title VIII to Insurance Redlining*, 75 NW. U. L. REV. 472, 472 (1981). See also Audrey G. McFarlane, *Race, Space, and Place: The Geography of Economic Development*, 36 SAN DIEGO L. REV. 295,

The racial demographics of coastal Alabama, Mississippi, and Louisiana raise a concern of redlining. Generally, minorities had higher levels of property damage from Hurricane Katrina in Alabama, Mississippi, and Louisiana compared to whites largely because of segregated housing in older and more poorly constructed homes.¹⁴² It has also been observed that black families were less likely to have purchased insurance to cover property damage and temporary living expenses resulting from a disaster like Hurricane Katrina.¹⁴³ The specific demographics in Florida affected by Hurricane Andrew are a mixture of socio-economic strata and any potential *de facto* redlining is less clear.¹⁴⁴

352 (1999) (asserting that insurance redlining contributes to the marginalization of inner-cities); David Dante Troutt, *Ghettoes Made Easy: The Metamarket/Antimarket Dichotomy and the Legal Challenge of Inner-City Economic Development*, 35 HARV. C.R.-C.L. L. REV. 427, 494 (2000) (identifying limited access to affordable insurance as a barrier to economic growth); David Dante Troutt, *Ghettoes Revisited: Antimarkets, Consumption, and Empowerment*, 66 BROOK. L. REV. 1, 16 (2000) (stating that lack of access to insurance both creates and perpetuates ghetto neighborhoods).

142. See *The Impact of Certain Governmental Contractor Liability Proposals on Environmental Laws: Hearings Before Subcomm. on Superfund and Waste Mgmt. of the Senate Comm. on Env't & Pub. Works*, 109th Cong. (2005) (statement of Dr. Beverly Wright, Director, Deep South Center for Environmental Justice, Xavier University) (noting differences in property damage because of housing demographics).

143. *Id.*

144. Traditionally, insurance companies have used objective, reliable criteria regarding risk as part of their underwriting process and do not use racially discriminatory factors. See Ruthann DeWolfe, Gregory Squires & Alan DeWolfe, *Civil Rights Implications of Insurance Redlining*, 29 DEPAUL L. REV. 315, 316–17 (1980) (asserting insurance companies' claims in defense of redlining). But see William E. Murray, *Homeowners Insurance Redlining: The Inadequacy of Federal Remedies and the Future of the Property Insurance War*, 4 CONN. INS. L.J. 735, 737 (1998) (discussing how insurance companies utilize underwriting practices to redline). Risk discrimination is not race discrimination. Identifying and accepting "good" risks while excluding or limiting "bad" risks is a fundamental part of the insurance underwriting process. See generally Kenneth S. Abraham, *Efficiency and Fairness in Insurance Risk Classification*, 71 VA. L. REV. 403 (1985) (discussing the mathematically modeled demographic risk factors based upon actual loss criteria methods insurers use to classify potential insureds and the possibilities for discrimination). Catastrophic losses occurring from natural disasters which are potentially recurring threaten the solvency of insurance companies if they are required to stay on the "bad" risk. See Albert B. Crenshaw, *Insurance Firms Curbing Coverage for Homeowners; Coastal Areas Most Affected by Retrenchment*, WASH. POST, May 8, 1993, at E01 (reporting that several insurance companies escaped permanent insolvency because of large capital infusions from their parent corporations). As an example, Prudential Property & Casualty Corporation had a capital base of \$575 million when Andrew struck and eventually paid out claims of more than \$1.3 billion. See David Satterfield, *Prudential Sues to Drop 25,000-Insurer Challenges State's Moratorium*, MIAMI HERALD, June 30, 1993, at A1. The losses from Andrew effectively bankrupted Prudential Property & Casualty Corp. Were it not for a capital infusion of \$900 million from its parent corporation, Prudential Insurance Company of America, Prudential Property & Casualty would have failed

In the traditional sense, redlining focuses upon idiosyncratic factors related to a specific minority characteristic or status.¹⁴⁵ But alleged *de facto* redlining occurring within the Gulf states does not involve idiosyncratic racial stereotyping because hurricane losses are non-discriminatory. The risk of catastrophic loss due to hurricane activity has no racial implication. Additionally, the geographic boundary involved, *i.e.*, a particular state's entire shoreline, is too broad a geographical area to claim that redlining has occurred. Because the exposed area is large, the numbers may not support *de facto* discrimination.

Regarding the stabilization of the homeowners market, insurance companies may develop plans to reduce their exposure to loss in the damage-prone areas. Legitimately, such plans may be necessary to

and its policyholders would have been left empty-handed to the tune of more than \$600 million. *Id.*

The process is inherently "unfair" because underwriting factors reflect generalizations and may not be based upon true statistical evidence of risk. However, an insurance company's legitimate differentiation among risks may produce classifications which effectively discriminate on the basis of race or some other protected class status. A plaintiff, for example, can make out a *prima facie* case of discrimination under the Fair Housing Act either on a theory of disparate impact or disparate treatment. See *Lapid-Laurel, L.L.C. v. Zoning Bd. of Adjustment of Scotch Plains*, 284 F.3d 442, 466 (3d Cir. 2002); *Gamble v. City of Escondido*, 104 F.3d 300, 304–05 (9th Cir. 1997). A facially neutral practice may violate civil rights laws if it has a "significantly discriminatory" impact upon minorities or perpetuates discrimination. *Cf. Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 645–46 (1989) (analyzing disparate impact claim under Title VII); *Paige v. California*, 291 F.3d 1141, 1145 (9th Cir. 2002) (same); *Moore v. Hughes Helicopters, Inc.*, 708 F.2d 475, 481 (9th Cir. 1983) (same). At least one commentator has asserted that race is the true factor that insurance companies use to deny insurance coverage or to set rates and terms. See Robert Yaspan, Note, *Property Insurance in the American Ghetto: A Study in Social Irresponsibility*, 44 S. CAL. L. REV. 218, 233, 236 (1971) (alleging the insurance industry's effective segregation of ghetto areas).

145. As an example, insurance companies did not want to underwrite homeowners' policies in riot-affected areas in the 1960s. See Badain, *supra* note 133, at 1. As a result of the riots and civil disturbances of the 1960s, the National Advisory Panel on Insurance in Riot-Affected Areas was established. *Id.* at 2. The panel examined the causes and effects of inner-city insurance on availability. See PRESIDENT'S NAT'L ADVISORY PANEL ON INS. IN RIOT-AFFECTED AREAS, MEETING THE INSURANCE CRISIS OF OUR CITIES 1–29 (1968) [hereinafter NAT'L ADVISORY PANEL]. The panel documented "[w]idespread refusals to insure . . . even where there had been no riots and where none were threatened. These were based primarily upon neighborhood characteristics, most significantly racial composition, without regard to the merits of the particular risk." Badain, *supra* note 133, at 6. The panel concluded that the main cause of insurance unavailability was the fear of catastrophic losses due to rioting. NAT'L ADVISORY PANEL, *supra* 2–7. As a result, the panel proposed that the federal government should offer non-cancellable low-cost riot insurance. *Id.* at 7–8. When an insurance company decides not to underwrite risk in blighted urban areas because of high crime rates or fear of property damage as a result of rioting, the *de facto* redlining that may occur from such a decision can be attributed to an erroneous racial characteristic—*i.e.*, propensity to commit crimes and riotous discourse.

protect remaining policyholders who would otherwise be left without coverage if a company became insolvent due to another catastrophic hurricane. These types of risk plans may include significant cancellations and non-renewals of existing homeowner policies.

Because of the unique low socio-economic demographics of the Gulf states, allowing insurance companies to withdraw from the coastal homeowner marketplaces raises the significant concern of *de facto* redlining. The question of insurance redlining may become mixed if the coastal counties contain a mixture of different socio-economic demographics. The greater the mix of socio-economic strata affected by an insurance company's withdrawal the greater the likelihood of establishing that *de facto* redlining is not occurring. An interesting question would be presented by an insurance company that wrote only high-end valued residential properties. If the program book of business contains only large valued residential properties, then the question of redlining may not be significant. Stabilization of the homeowner marketplace should take into consideration specific underwriting qualifications and limitations on acceptable risk. For those insurance companies that reach a high-end niche marketplace, the need to stabilize the overall marketplace may not be significantly impacted by a withdrawal from the marketplace of the high-end writer.

*B. Due Process Clause Challenges*¹⁴⁶

A state's authority to regulate the business of insurance has been upheld as constitutional under the Due Process Clause.¹⁴⁷ In order to prevail under the Due Process Clause,¹⁴⁸ the insurance company would need to establish that the applicable moratorium legislation was "clearly arbitrary and unreasonable, having no substantial rela-

146. There is significant due process case law involving the method of establishing and reviewing insurance rates; however, the case law does not address moratoriums. *See* 20th Century Ins. Co. v. Garamendi, 878 P.2d 566 (Cal. 1994); *Smith v. Dep't of Ins.*, 507 So.2d 1080 (Fla. 1987); *Fla. Welding & Erection Serv., Inc. v. Am. Mut. Ins. Co. of Boston*, 285 So.2d 386 (Fla. 1973); *Caldwell v. Ins. Co. of N. Am.*, 218 S.E.2d 754 (Ga. 1975); *Louisville Auto Club v. Dep't of Ins.*, 384 S.W.2d 75 (Ky. 1964); *Nat'l Council on Comp. Ins. v. Superintendent of Ins.*, 481 A.2d 775 (Me. 1984); *Katz v. Ins. Comm'r*, 454 A.2d 387 (Md. Ct. Spec. App. 1983); *Auto. Insurers Bureau of Mass. v. Comm'r of Ins.*, 718 N.E.2d 830 (Mass. 1999); *Liab. Investigative Fund Effort, Inc. v. Mass. Med. Prof'l Ins. Ass'n*, 636 N.E.2d 1317 (Mass. 1994); *Shavers v. Kelley*, 267 N.W.2d 72 (Mich. 1978); *Appeal of Nationwide Ins. Co.*, 411 A.2d 1107 (N.H. 1980); *State Farm Mut. Auto. Ins. Co. v. State*, 590 A.2d 191 (N.J. 1991); *Home Indem. Co. v. Arapahoe Drilling Co.*, 848 P.2d 1131 (N.M. App. 1993); *Am. Nat'l Ins. Co. v. Ingram*, 303 S.E.2d 649 (N.C. App. 1983); *In re Investigation of Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 609 N.E.2d 156 (Ohio 1993); *Blue Cross of Ne. Ohio v. Ratchford*, 416 N.E.2d 614 (Ohio 1980); *Golden Rule Ins. Co. v. Ins. Dep't.*, 641 A.2d 1255 (Pa. Commw. Ct. 1994); *Liberty Mut. Fire Ins. Co. v. Commonwealth of Pennsylvania*, 597 A.2d 235 (Pa. Commw. Ct. 1991); *Prudential Prop. & Cas. Ins. Co. v. Dep't of Ins.*, 595 A.2d 649 (Pa. Commw. Ct. 1991); *Ohio Cas. Ins. Co. v. Ins. Dep't of Commonwealth of Pa.*, 585 A.2d 1160 (Pa. Commw. Ct. 1991); *Geeslin v. State Farm Lloyd's*, 255 S.W.3d 786 (Tex. App. 2008); *In re Vt. Health Serv. Corp.*, 586 A.2d 1145 (Vt. 1990); *Fire Ins. Rating Bureau v. Rogan*, 91 N.W.2d 372 (Wis. 1958).

147. *See* *Cal. State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105, 110–11 (1951) (determining that the diminution in value of the insurer's business due to governmental regulation was not a taking of property without due process of law); *id.* at 110 n.2 (citing numerous cases in which the Court has upheld insurance regulations against Due Process challenges).

148. The Due Process Clause of the Fourteenth Amendment provides that "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV, § 1. The right to contract is a liberty interest guaranteed by the Constitution. *See* *Chicago, Burlington & Quincy R.R. Co. v. McGuire*, 219 U.S. 549, 566–67 (1911). For a discussion of the scope of constitutional liberty interests, see Deana Pollard Sacks, *Elements of Liberty*, 61 SMU L. REV. 1557 (2008). When a state attempts to limit contractual rights, the Due Process Clause "provides heightened protection against government interference with certain fundamental rights and liberty interests." *Troxel v. Granville*, 530 U.S. 57, 65 (2000) (citing *Washington v. Glucksburg* 521 U.S. 702, 719 (1997)). *See also* *Daniels v. Williams* 474 U.S. 327, 331 (1986) (stating that the substantive component of the Due Process Clause protects individuals from "certain government actions regardless of the fairness of the procedures used to implement them."). Notwithstanding the liberty interest and the right to contract, the Supreme Court has observed that "neither property rights nor contract rights are absolute." *Nebbia v. People*, 291 U.S. 502, 523 (1934) (footnotes omitted); *see also* *Frisbie v. United States*, 157 U.S. 160, 165 (1895) ("It is within the undoubted power of government to restrain some individuals from all contracts, as well as all individuals from some contracts."). Thus the state can legislatively supervise contracts through reasonable regulations and prohibitions imposed in the interests of the community. *See McGuire*, 219 U.S. at 567.

tion to the public health, safety, morals, or general welfare.”¹⁴⁹ This rational basis review is highly-deferential to state regulatory decisions.¹⁵⁰ As long as there is any conceivable justification for enacting the legislation, the rational basis review will find that the state action is constitutional.¹⁵¹ Where a state has enacted moratorium legislation in order to ostensibly preclude insurance redlining or to prevent economic disaster in the real estate market, it cannot be said that the moratorium legislation lacks a rational justification for enactment.¹⁵²

C. Contract Clause Challenges

A viable Contract Clause¹⁵³ claim requires insurance companies to make a sufficient showing that the contested moratorium legisla-

149. *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 395 (1926).

150. *See* *Turner v. Glickman*, 207 F.3d 419, 426 (7th Cir. 2000).

151. *See* *Gallo v. U.S. District Court*, 349 F.3d 1169, 1181 n.6 (9th Cir. 2003) (“[I]t is well-established that rational basis scrutiny permits the court to consider any *conceivable* justifications for enacting the law.”).

152. *See* *Vesta Fire Ins. Corp. v. Florida*, 141 F.3d 1427, 1430 n.5 (11th Cir. 1998) (deciding that the State of Florida did not lack a rational basis for passing moratorium legislation after Hurricane Andrew and summarily dismissing insurer’s Substantive Due Process claim with little discussion). *But see* *People ex rel. Lewis v. Safeco Ins. Co. of Am.*, 414 N.Y.S.2d 823, 829 (Sup. Ct. 1978) (finding that the statutory provision as applied to defendant insurers conscripted and compelled them to continue doing business at a loss in the state in violation of their due process rights under the Fourteenth Amendment).

153. The Contract Clause of the U.S. Constitution provides that “[n]o State shall . . . pass any . . . law impairing the obligation of contracts.” U.S. CONST. art. I, § 10. The Contract Clause applies to state governments, not the federal government. *See* *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733 n.9 (1984) (citing 5 J. ELLIOTT, *DEBATES ON THE FEDERAL CONSTITUTION* 546 (2d ed. 1876); 2 *THE RECORDS OF THE FEDERAL CONVENTION OF 1787*, at 619 (Max Ferrand ed., 1911)) (“It could not justifiably be claimed that the Contract Clause applies, either by its own terms or by convincing historical evidence, to actions of the National Government.”). The Contract Clause limits state’s power to modify its own contracts as well as to regulate contracts between private parties. *See* *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 17 (1977) (“It long has been established that the Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties.” (citing *Dartmouth Coll. v. Woodward*, 17 U.S. 518 (1819); *Fletcher v. Peck*, 10 U.S. 87, 137–39 (1810))). Not every modification of a contractual promise impairs an obligation of the contract sufficient to establish a violation of the Contract Clause. *See* *City of El Paso v. Simmons*, 379 U.S. 497, 507–08 (1965) (“For it is not every modification of a contractual promise that impairs the obligation of contract under federal law, any more than it is every alteration of existing remedies that violates the Contract Clause.”). “Although the language of the Contract Clause is facially absolute, its prohibition must be accommodated to the inherent police power of the State ‘to safeguard the vital interests of its people.’” *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 410 (1983) (citing *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 434 (1934)); *see also* *Veix v. Sixth Ward Bldg. & Loan Ass’n of Newark*, 310 U.S. 32, 38–39 (1940) (noting that all contracts are made subject to the paramount authority of the state to

tion substantially impaired its insurance contract with its insured. Central to this argument is the understanding that an insurance policy is a contract that provides coverage for a *specified* risk for a *specified* policy period (typically one year). At the end of the policy period, the insurance company reevaluates the risk and decides whether to remain subject to the risk or to cancel the policy. Under moratorium legislation, it can be argued that the legislation would likely force an insurance company to continue the contractual relationship that it could otherwise terminate pursuant to the contract terms. It can be argued that a forced continuation of a contract that normally would expire constitutes a substantial impairment of the insurance company's contractual rights.

Once the insurance company establishes a substantial impairment of its contracts, the burden shifts to the state to establish a significant and legitimate public purpose behind the moratorium legislation. The state may be able to demonstrate a legitimate public purpose by precluding insurance redlining and by protecting and stabilizing the state's economy, particularly the housing market.¹⁵⁴ This public purpose does not need to address an emergency or temporary situation in order to be valid.¹⁵⁵

The question that the court will have to answer is whether the

regulate health, morals, and safety, as well as the economic needs of society). Courts consider three factors in evaluating any allegation of a breach of the Contract Clause: (1) whether the law substantially impairs a contractual relationship; (2) whether there is a significant and legitimate public purpose for the law; and (3) whether the adjustments of rights and responsibilities of the contracting parties are based upon reasonable conditions and are of an appropriate nature. See *Energy Reserves Grp.*, 459 U.S. at 410–13 (discussing the factors to be applied in a Contract Clause analysis).

“Total destruction of contractual expectations is not necessary for a finding of substantial impairment.” *Id.* at 411; see also *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978) (“The severity of the impairment measures the height of the hurdle the state legislation must clear.”); *Campanelli v. Allstate Life Ins. Co.*, 322 F.3d 1086, 1098 (9th Cir. 2003) (“The more severe the impairment, the more searching the examination of the legislation must be.”). In determining the extent of the impairment, a court must decide whether the government has previously regulated the industry of the party asserting the Contract Clause claim. See *Veix*, 310 U.S. at 38 (“When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic.”); *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908) (“One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them.”).

154. See *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 226–28 (1986).

155. See *Energy Reserves Grp.*, 459 U.S. at 412 (recognizing justifications that address broader social problems and not merely emergency situations although the state must offer a significant and legitimate purpose for the regulation).

moratorium legislation is animated by a legitimate purpose and then whether the state's modification of the contract rights and responsibilities are based upon reasonable conditions.¹⁵⁶ "Unless the State itself is a contracting party[,] . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure."¹⁵⁷

D. Equal Protection Clause Challenges

Another possible constitutional objection is an Equal Protection Clause challenge. The Fourteenth Amendment provides that "No State shall . . . deny to any person within its jurisdiction the equal protection of the laws."¹⁵⁸ It can be argued that a moratorium compels insurers doing business in a state with the moratorium to commit capital to that state and its resident policyholders while at the same time restrict the insurer's available capital to underwrite insurance policies in other states. This has the effect of not only limiting insurance, but also raising insurance premiums in other states, resulting in injury to non-residents who seek to purchase policies from carriers doing business in a state with a moratorium. Non-resident policyholders in other states may also be insured by a carrier whose health and solvency is jeopardized by the moratorium. It can be argued that the moratorium violates the Equal Protection Clause because it discriminates against citizens of other states on the basis of their residency.

The Equal Protection Clause is not violated merely because a state has made distinctions between groups; namely, the state treats different classes of persons in different ways.¹⁵⁹ The Equal Protection Clause precludes states from classifying persons in a discriminatory fashion or placing individuals into different classes on the basis of criteria wholly unrelated to the objective of the legislation.¹⁶⁰ In the area of economics and social welfare, a state can classify people differently so long as the classifications are rationally related to a legitimate state purpose.¹⁶¹ The classification, however, cannot be arbitrary, re-

156. *Id.* at 412-13 (discussing modification of contracts by states).

157. *Id.*

158. U.S. CONST. amend. XIV, § 1.

159. See *McDonald v. Bd. of Election Comm'rs*, 394 U.S. 802, 810-11 (1969); *Ry. Express Agency, Inc. v. New York*, 336 U.S. 106, 110 (1949).

160. *Reed v. Reed*, 404 U.S. 71, 76-77 (1971).

161. See *Dandridge v. Williams*, 397 U.S. 471, 485 (1970).

fer to distinctions that affect any fundamental rights, or affect some suspect class of persons.¹⁶² Courts have held that classifications that merely distinguish between residents from nonresidents do not require application of the strict scrutiny test.¹⁶³ Nevertheless, a state cannot favor its own residents based on the view that the state may take care of “its own.”¹⁶⁴

A similar argument was addressed by the district court of New Jersey in *Ballesteros v. New Jersey Property Liability Insurance Guaranty Ass’n*.¹⁶⁵ In *Ballesteros*, Margarita Ballesteros was shot in the foot and injured while in La Vaca Loca Tavern in Elizabeth, New Jersey. The tavern was owned by Jose Gonzales and insured by the Long Island Insurance Company. During the term of the policy, the Long Island Insurance Company suffered severe financial difficulties and, ultimately, the Supreme Court of the State of New York ordered the New York Superintendent of Insurance to take possession of the carrier’s assets and to rehabilitate the carrier. The order also terminated all policies issued by the carrier to policyholders outside of the State of New York. Acting under the authority granted by the order, the Superintendent of Insurance issued notices of cancellation, which terminated all policies embraced by the court order, including the policy issued to the tavern.¹⁶⁶

After the incident, Ms. Ballesteros sued the tavern for negligence and was awarded a default judgment. Ms. Ballesteros then sued the

162. *Mass. Bd. of Ret. v. Murgia*, 427 U.S. 307, 312 (1976).

163. *Whiting v. Town of Westerly*, 942 F.2d 18, 23 (1st Cir. 1991) (“The utilization of different, but otherwise constitutionally adequate, procedures for residents and nonresidents does not, by itself, trigger heightened scrutiny under the Equal Protection Clause.”); *see also* *Ward v. Bd. of Exam’rs of Eng’rs*, 409 F. Supp. 1258, 1259 (D.P.R. 1976), *aff’d*, 429 U.S. 801 (1977). If a classification involves invidious discrimination by either impermissibly interfering with a fundamental right or it operates to the peculiar disadvantage of an inherently suspect class, then a court utilizes the strict scrutiny test to determine whether the classification has been precisely tailored to serve a compelling governmental interest. *See Plyler v. Doe*, 457 U.S. 202, 216–217 (1982); *Murgia*, 427 U.S. at 312.

164. *See Hooper v. Bernalillo Cnty. Assessor*, 472 U.S. 612, 623 (1985) (holding that the state cannot create two tiers of resident Vietnam veterans that identifies resident veterans who settled in the state after a certain date as “second-class citizens” by not providing tax exemptions for those veterans); *Zobel v. Williams*, 457 U.S. 55, 63 (1982) (holding that Alaskan statute using length of state residence to calculate distribution of dividends from the state’s oil reserves violated the Equal Protection Clause). *Vlandis v. Kline*, 412 U.S. 441, 449–50, & n.6 (1973) (holding that the state violates the Equal Protection Clause when it provides lower in-state tuition for established residents compared to new residents).

165. 530 F. Supp. 1367 (D.N.J. 1982).

166. *Id.* at 1369.

New Jersey Guaranty Association, claiming that the Association was liable on the claim against the tavern because its carrier, Long Island Insurance Company, was defunct. The Association denied liability and alleged that the policy was terminated by the New York court's order of rehabilitation and that, therefore, the tavern did not have a "covered claim" against the insurer within the meaning of the New Jersey Property Liability Insurance Guaranty Act.¹⁶⁷

Ms. Ballesteros argued, among other things, that the New York court's cancellation of all policies held by nonresidents of the state violated the equal protection rights of the insured. The district court rejected this assertion, noting that classifications distinguishing residents from nonresidents need only be rationally related. The district court held that the New York court, acting in the interests of the policyholders and the public, determined that in order to successfully rehabilitate the carrier, it was necessary to cancel the policies held by non-resident insureds.¹⁶⁸ According to the district court, the New York court was attempting to restrict the carrier's business and ease the costs of administration by requiring that the carrier do its business locally. "Because the New York court's order was a rational attempt to reduce the [carrier's] potential liabilities . . . and to reduce administrative expenses, [the district court held] that the equal protection rights of the insured were not violated."¹⁶⁹

As previously discussed, states will likely have a rationally related basis for the imposition of a moratorium notwithstanding any adverse effects the moratorium may have on out-of-state residents. Consequently, any equal protection clause challenge will likely not prevail.

V. FEDERAL SOLUTIONS TO STATE MORATORIUM PROTECTIONS

The effects of a catastrophic hurricane loss threaten to reach outside the boundaries of the Gulf states and other states prone to hurricanes.¹⁷⁰ The type of emergency moratorium utilized in Florida can cause significant multi-state market disruption. Both national and regional insurance companies could be placed at financial risk because of a requirement that they maintain significant risk exposure to re-

167. *Id.* at 1369-70.

168. *Id.* at 1372.

169. *Id.*

170. See *Protecting Americans from Catastrophic Risk: Joint Hearing before the Subcomm. on Capital Mkts., Ins., & Gov't Sponsored Enters. & the Subcomm. on Oversight & Investigations of the H. Comm. on H. Fin. Servs.*, 109th Cong. 131 (2006).

current hurricane losses during the period of the moratorium. Given the magnitude of potential hurricane exposure, any Category 4 or Category 5 hurricane could tip the scales on insolvency with ripple effects in each state of operation of the national or regional insurance company. Insolvency risk would be unpredictably increased on a multi-state level. Multi-state insolvencies would deplete individual state's property and casualty guarantee funds in order to make policyholders whole.¹⁷¹ Because reinsurers are subject to more limited government regulation, reinsurers may move to exclude hurricane risk without governmental approval. The withdrawal of reinsurers from the hurricane market will leave primary insurers at risk of insolvency in the event of a major hurricane loss.

What alternatives to state moratoriums are available for the management of mega-catastrophes that may be inflicted by a Category 4 or Category 5 hurricane?¹⁷² Three principal alternatives exist. Under the first alternative, Congress can enact federal legislation prohibiting states from imposing moratoriums. This approach, however, does not resolve the fundamental issue because insurers will likely withdraw

171. See 26 JOHN ALAN APPLEMAN, ET AL., APPLEMAN ON INSURANCE § 166.1 (2d ed. 2006) (discussing the creation and maintenance of state guarantee associations in which money is pooled to put towards the paying of claims of insolvent insurers). All fifty states and Puerto Rico have enacted laws with which require the establishment of these associations. *Id.* In the 1960s insolvencies of several property-liability insurance companies sparked an interest in regulating insurance companies at the federal level. Elizabeth F. Brown, *The Development of International Norms for Insurance Regulation*, 34 BROOK. J. INT'L L. 953, 974 (2009). A federal insurance act was proposed which would have allowed insurers to seek either a federal or a state charter. *Id.*; see also Federal Insurance Act of 1977, S. 1710, 95th Cong. § 201 (1977). The federal insurance act was not enacted. Brown, *supra*, at 974. "In 1969, the NAIC proposed model legislation for state guaranty funds. By 1982, all fifty states, the District of Columbia, and Puerto Rico had adopted some form of state guarantee fund legislation . . ." *Id.* There was renewed interest in the federal regulation of insurance in the 1980s and early 1990s due to several insurance company bankruptcies. See Jonathan R. Macy & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. Rev. 13, 15 (1993). A report of the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce found, in 1990, that existing state regulations regarding insurance company solvency were inadequate. Brown, *supra*, at 975. In response, a proposal creating a dual system of insurance company solvency regulation was proposed including the creation of a federal guarantee fund for federally chartered insurance companies. *Id.* This proposal failed. Thereafter many states adopted "risk-based capital requirements [for insurers similar to the banking requirements], a financial regulation accreditation program, and an initiative to codify statutory accounting principles." *Id.*

172. Katrina was a Category 5 hurricane. Robert J. Rhee, *Catastrophic Risk and Governance After Hurricane Katrina: A Postscript to Terrorism Risk in a Post-9/11 Economy*, 38 ARIZ. ST. L.J. 581, 595 (2006). In fact, in 2005 a record three hurricanes reached Category 5 status including Katrina. *Id.* at 595-96.

from hurricane-prone areas or substantially increase premiums, leaving homeowners uninsured or underinsured. Under the second alternative, the federal government would become the reinsurer of last resort for hurricane insurance, which would allow for a stable homeowner insurance marketplace in regions most vulnerable to hurricanes. The second alternative does not address the market stability issues within the affected state but would prevent a ripple effect of potential insolvency, which the Florida model of emergency moratorium threatens. Under the third approach, the federal government would create an optional federal charter for insurance companies. For those insurance companies insuring business in hurricane-prone states, they could escape the reach of state moratorium legislation by becoming federally chartered.

A. Federal Legislation Prohibiting State-Imposed Moratoriums

As previously discussed, after the passage of the McCarran-Ferguson Act, states have jurisdiction over insurance regulation. Nevertheless, Congress can enact federal legislation that completely preempts state insurance laws (such as Florida's moratorium legislation), if the federal legislation specifically relates to the "business of insurance."¹⁷³ Thus, Congress can enact federal legislation that preempts states from imposing moratoriums and allow insurers to withdraw from states to avoid insolvency due to catastrophic hurricane losses. If Congress enacted such legislation, then the likely result is that insurers would cease to write homeowners coverage in those states, leaving homeowners with two options: (1) purchasing more expensive insurance coverage, or (2) remaining uninsured.¹⁷⁴ Such federal legislation may not fundamentally resolve the issues of encouraging homeownership in those areas.¹⁷⁵ To accomplish such

173. 15 U.S.C. § 1011 (1994). *See, e.g.*, *New York v. United States*, 505 U.S. 144, 178 (1992) ("The Constitution instead gives Congress the authority to regulate matters directly and to pre-empt contrary state regulation."); *Fed. Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742, 759 (1982) ("Clearly, Congress can pre-empt the States completely in the regulation of retail sales by electricity and gas utilities and in the regulation of transactions between such utilities and cogenerators.").

174. *See* sources cited *supra* note 32.

175. The Hurricane Katrina and Rita Recovery Homesteading Act of 2005, S. 2008, 109th Cong. (2005), sought to assist in the rebuilding of neighborhoods in Alabama, Louisiana, and Mississippi that were damaged by Hurricane Katrina, by promoting homeownership opportunities by giving displaced low-income families the opportunity to purchase a home owned by the federal government. President George W. Bush was in favor of such an act in part because the

goals, the federal government can, alternatively, regulate the hurricane insurance market.

B. Marketplace Dysfunction Supports a Federal Insurance Program

Managing the risk from catastrophic hurricanes presents a difficult challenge to the effective functioning of insurance markets.¹⁷⁶ The first challenge is one of diversification. Diversification is a fundamental premise of an effective insurance market relating to the ability of insurance companies to diversify risk through the law and large numbers.¹⁷⁷ As an example, where the risk of being insured is the threat of loss of crops due to flood, diversification fails when the crops being insured are in the same floodplain. This is because all of the crops share a common element of, and thus high correlation of, risk.¹⁷⁸ Thus, the concept of diversification works only when the risks being pooled are independent of each other.¹⁷⁹ One commentator has even observed that this “lack of independence in the risks being pooled renders the risk-pooling arrangement useless.”¹⁸⁰ Catastrophic hurricanes present a difficult challenge in the form of diversification because “diversification is difficult or impossible because every member of a large population is likely to be affected adversely

Gulf region has some of the most beautiful and historic places in America. *President Bush Delivers Remarks on Hurricane Katrina Recovery*, WASH. POST, Sept. 15, 2005, <http://www.washingtonpost.com/wp-dyn/content/article/2005/09/15/AR2005091502252.html>. However, the act never passed Congress.

176. A properly functioning insurance marketplace allocates risk and creates appropriate incentives for responsible behavior, creates opportunities for spreading economic consequences of loss, creates victim compensation and prevents over-deterrence. *See generally*, Maksim Rakhlin, *Regulating Nanotechnology: A Private-Public Insurance Solution*, 2008 DUKE L. & TECH. REV. 2, 12 (2008). Four factors must exist for a properly functioning insurance market: (1) there must be accessibility (the probability and severity of losses must be quantifiable to allow pricing); (2) there must be sufficient randomness (time of the insured event must be unpredictable and occurrence independent of the will of the insured); (3) there must be mutuality (exposed persons must join together to build a community to share and diversity risk); and (4) there must be economic feasibility (insurers must be able to charge a premium which is commensurate with the risk, giving them a fair chance to write the business profitably in the long term). *Id.* at 13.

177. Jerry & Roberts, *supra* note 48, at 843.

178. *Id.* at 843–44.

179. *Id.* There are three factors that make diversification of a hurricane risk portfolio difficult: (1) the probability and severity of risks are difficult if not impossible to assess; (2) many companies, industry sectors, and geographical regions are affected simultaneously; and (3) predicting the magnitude of a possible event exceeds the capacities of the private industry.

180. *Id.* at 844.

at the same time.”¹⁸¹

A second problem for the creation of a hurricane-insurance marketplace is ambiguity. The concept of ambiguity has “multiple facets, with two of the principal ones being *uncertainty of frequency* and *uncertainty of consequence*.”¹⁸² Traditionally, “[w]hen the frequency of a loss is uncertain, insurers are unlikely to insure it or will undertake to do so only for a very high premium.”¹⁸³ The problem is that “the weight of scientific authority suggests that hurricane frequency is undergoing a shift that will distinguish the next few from the past few decades.”¹⁸⁴ So, the accumulated historical record on hurricane frequency does not give an accurate basis predicting future events. “Uncertainty of consequence is a related kind of ambiguity.”¹⁸⁵ This type of ambiguity has a “wide range of potential consequence . . . depend[ing up]on human behavior and is therefore inherently difficult to predict.”¹⁸⁶

Another problem may be the “lack of demand for coverage.”¹⁸⁷ One commentator has noted that there are three facets to this problem. First, “very few people voluntarily protect themselves against a hazard unless they have past experience with it or know someone else who has endured it.”¹⁸⁸ Second, the demand for insurance can be suppressed by budgetary constraints as consumers turn away from insurance products because their lack of experience with the manifested risk makes the insurance product appear to have little value.¹⁸⁹ Third, the “expectation of ex post government[al] disaster assistance may reduce the demand for coverage.”¹⁹⁰ One explanation for “the lack of demand for catastrophic insurance coverage” focuses on the actions of “rational consumers [who] may well forgo purchasing insurance now because they expect” to receive government benefits—or “free

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.* (emphasis omitted).

186. *Id.* at 845.

187. *Id.* (emphasis omitted).

188. *Id.* & n.32 (citing Howard Kunreuther, *Has the Time Come for Comprehensive Natural Disaster Insurance?*, in *ON RISK AND DISASTER: LESSONS FROM HURRICANE KATRINA* 178 (Ronald J. Daniels et al. eds., 2006)).

189. *Id.*

190. *Id.* For a discussion of federal disaster assistance previously provided for natural disasters, see *supra* notes 4–11.

insurance”—later through “government grants, loans, or other forms of post-disaster insurance.”¹⁹¹

Whether the consuming public will ultimately decide to purchase hurricane insurance is problematic. California’s experience with earthquake insurance exemplifies the problem. In 2003, “[o]nly seventeen percent of Californians ha[d] earthquake insurance. This figure [was] down from twenty-eight percent before the Northridge earthquake in 1994, primarily because of the very high premiums.”¹⁹² To date, the federal government has not enacted a special provision for earthquake insurance.¹⁹³

The problem of demand became evident after the passage of the National Flood Insurance Act (NFIP).¹⁹⁴ Congress was initially dissatisfied with the lack of commitment being made to the Program by the municipalities after its enactment. Therefore, Congress added additional incentives for communities to participate in the Program. At that time, Congress was concerned because many communities had decided to remain outside the Program and avoid paying any insurance premiums since they could collect federal disaster relief.¹⁹⁵ These incentives took the form of the Flood Disaster Protection Act of 1973.¹⁹⁶ The Flood Disaster Protection Act of 1973 required the purchase of flood insurance as a condition to receiving any form of federal or federally related financial assistance for the acquisition or construction of insurable buildings and mobile homes within a specific identified special flood, mudslide, or flood related erosion hazard area located within any community participating in the Program.¹⁹⁷

191. Adam F. Scales, *A Nation of Policyholders: Governmental and Market Failure in Flood Insurance*, 26 *MISS. C. L. REV.* 3, 10 & n.25 (2006) (internal quotation marks omitted) (citing Raymond J. Burby, *Hurricane Katrina and the Paradoxes of Government Disaster Policy: Bringing About Wise Governmental Decisions for Hazardous Areas*, 604 *ANNALS AM. ACAD. POL. & SOC. SCI.*, Mar. 2006, at 171, 178).

192. Jeffrey Manns, *Insuring Against Terror?*, 112 *YALE L.J.* 2509, 2518 n.46 (2003).

193. As it does with homes in earthquake zones or within an estimated geographical zone for hurricanes, the federal government could require homeowners seeking FHA financing to participate in a federal insurance program.

194. The National Flood Insurance Act of 1968 was enacted by Title XIII of the Housing and Urban Development Act of 1968, Pub. L. No. 90-448, §§ 1301–1377, 82 Stat. 476, 572–89 (codified as amended at 42 U.S.C. §§ 4001–4130 (2012)), to provide previously unavailable flood insurance protection to property owners in flood-prone areas.

195. *United States v. St. Bernard Parish*, 756 F.2d 1116, 1120 (5th Cir. 1985).

196. See *Tex. Landowners Rights Ass’n v. Harris*, 453 F. Supp. 1025, 1027 (D.D.C. 1978), *aff’d*, 598 F.2d 311 (D.C. Cir. 1979).

197. *Id.* at 1027–28; see also 42 U.S.C. § 4012(a). If flooding in a declared disaster area occurs in a non-participating SFHA community, no federal financial assistance can be provided

The Flood Disaster Protection Act also required that any community containing one or more special flood hazards would receive no federal financial assistance unless the community in which the area was located was then participating in the NFIP.

C. Creation of a Federal Hurricane Insurance Program

In determining what potential natural catastrophes should be considered for federal intervention, the covered natural catastrophes should have basic features: (1) they occur frequently and unpredictably; and (2) they can impose huge costs when they do occur.¹⁹⁸ Natural catastrophes cannot be anticipated in a true actuarial sense.¹⁹⁹ But natural catastrophes generally follow proximate patterns while the incidents of an occurrence has a significant degree of randomness in its timing and location.²⁰⁰ To some extent insurance companies can attempt to estimate the threat of natural catastrophes through tools like hazard risk maps and historical estimates of the probability of an event's occurrence and levels of compensation likely to result.²⁰¹ But such probabilistic tools have limits.²⁰²

A second compelling argument for government intervention involves the liquidity concern facing the insurance and reinsurance marketplace in the event of future hurricane catastrophes. One commentator opines that "only the federal government has the deep (and theoretically unlimited) pockets through its taxing power to endure

for permanent repair or reconstruction of insurable buildings. *See id.* § 5172(a). If the community applies and is accepted into the NFIP within six months of a presidential disaster declaration, the limitations on federal disaster assistance are lifted, however. *See id.* § 5172. This community option to retroactively opt in after a declared disaster creates a free-rider problem.

198. Manns, *supra* note 192, at 2516; *see also* Weimin Dong et al., *A Rational Approach to Pricing of Catastrophe Insurance*, 12 J. RISK & UNCERTAINTY 201, 201 (1996).

199. Manns, *supra* note 192, at 2517; *see also* Dong et al., *supra* note 198, at 201.

200. Manns, *supra* note 192, at 2517.

201. *Id.*

202. One commentator has cogently described the landscape contexts:

All risks are not the same. The combinations of source, frequency, severity, manageability, predictability, and dependent variables are as unique as fingerprints. Past experiences have ranged in scale from localized events to mega-catastrophes. Risks must not only be identified, they must be assessed for the purpose of prioritization When a risk is so infrequent as to make the extrapolation of any data inadequate, its assessment becomes difficult. Assessment is shaped by empirical data (if available) and judgment (particularly where data is insufficient). Perceptions of risk play a vital role. Faulty perceptions have led to failed assessments, and such failures have plagued many endeavors.

Rhee, *supra* note 172, at 587–88 (citations omitted).

the financial shocks of the most severe catastrophic events.”²⁰³ As an example, with respect to the World Trade Center catastrophe the federal government granted the City of New York \$20 billion on an emergency basis.²⁰⁴

In addition to federal disaster relief, federal insurance programs are already available for certain types of catastrophic risks, including insurance for political risk associated with American private investment in developing countries,²⁰⁵ nuclear energy development,²⁰⁶ ri-

203. Manns, *supra* note 192, at 2518.

204. See *id.* at 2519 (citing Carl Hulse, *Congress at Ground Zero: The Special Assembly*, N.Y. TIMES, Sept. 7, 2002, at B1).

205. 22 U.S.C. § 2191–2200a (2000) (stating that political risk insurance is to facilitate private investment by U.S. businesses in developing countries).

206. See, e.g., Atomic Energy Damages Act of 1957, Pub. L. No. 85-256, 71 Stat. 576 (1957) (codified as amended in scattered sections of 42 U.S.C.) (stating that operators of nuclear reactors are required to obtain insurance in the private market to the maximum amount available and capitalize a second insurance fund with implicit government financial backing for accidents in which damages exceed the combined limits of private insurance in the secondary fund).

When Congress passed the Atomic Energy Act of 1946, it was contemplated that the federal government would have a monopoly on the development of nuclear power. *Duke Power Co. v. Carolina Envtl. Study Grp., Inc.*, 438 U.S. 59, 62 (1978); see also Act of Aug. 1, 1946, ch. 724, 60 Stat. 755. However, it was later determined by Congress that it was in the national interest for the United States government to encourage the private sector to become involved in the peaceful development of nuclear energy under a program of federal regulation and licensing. *Duke Power Co.*, 438 U.S. at 63; see also H.R. REP. NO. 83-2181, at 1–11 (1954). This policy was implemented by the Atomic Energy Act of 1954. *Duke Power Co.*, 438 U.S. at 63; see Act of August 30, 1954, ch. 1073, 69 Stat. 909 (codified as amended at 42 U.S.C. §§ 2011–2281 (1970 ed. & Supp. V)). The Atomic Energy Act of 1954 provided for licensing of private construction, ownership, and operation of commercial nuclear-power reactors under the supervision of the Atomic Energy Commission. See *Power Reactor Dev. Co. v. Elect. Workers*, 367 U.S. 396 (1961). In response to the Atomic Energy Act of 1954, private industry formed a consortium of interested companies for the development of an experimental power plant. But it became apparent that profits from the private-exploitation energy were uncertain and the accompanying risks were substantial. E.g., Harold P. Green, *Nuclear Power: Risk, Liability, and Indemnity*, 71 MICH. L. REV. 479, 479–81 (1973).

A major obstacle to the development of a private nuclear-power industry was the risk of potentially vast liability in the event of a nuclear accident of a sizable magnitude. *Duke Power Co.*, 438 U.S. at 64. Although private industry and the Atomic Energy Commission were confident that such a disaster would not occur, the very uniqueness of nuclear power meant that the possibility remained and the potential liability exceeded the ability of the industry and private insurance companies to absorb the risk. *Id.*; see *Hearings on Government Indemnification for Private Licensees and AEC Contractors Against Reactor Hazards Before the J. Comm. on Atomic Energy*, 84th Cong., 2d Sess. 122–24 (1956) [hereinafter *Hearings on Government Indemnification*]. The industry advised Congress that it would be forced to withdraw from the development of peaceful nuclear energy if the industry’s liability were not limited by appropriate legislation. *Duke Power Co.*, 438 U.S. at 64; see *Hearings on Government Indemnification*. Congress addressed this concern with the passage of the Price-Anderson Act in 1957, 71 Stat. 576 (codified as amended at 42

ots and civil disorders,²⁰⁷ crop failure,²⁰⁸ and terrorism.²⁰⁹ But one

U.S.C. § 2210). The Act had the dual purpose of “protect[ing] the public and . . . encourag[ing] the development of the atomic energy industry.” 42 U.S.C. § 2012(i). The original form of the Act limited the aggregate liability for a single nuclear incident to \$500 million plus the amount of liability insurance available on the private market. David F. Cavers, *Improving Financial Protection of the Public Against the Hazards of Nuclear Power*, 77 HARV. L. REV. 644, 646 (1965). The Act required the nuclear facility to purchase the maximum available amount of privately underwritten public-liability insurance. *Id.* Under the Act, if damages from a nuclear disaster exceeded the amount of the private insurance coverage, the federal government would indemnify the licensee in an amount not to exceed \$500 million. *Id.* Thus, the actual ceiling on liability was the amount of the government’s indemnification obligation of \$500 million plus the amount of private insurance coverage available. *Id.*

207. Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (1968) (codified as amended in scattered sections of 5, 12, 15, 18, 31, 38, 40, 42 & 49 U.S.C.).

208. Congress passed the Federal Crop Insurance Act, Title V of the Agricultural Act of 1938, Pub. L. No. 75-430, 52 Stat. 72 (1938). The purpose of the Act was to improve the economic stability of agriculture through a sound system of crop insurance. *Id.* § 502. The Act created the Federal Crop Insurance Corporation. *Id.* § 503. The Federal Crop Insurance Corporation was empowered to insure or to provide reinsurance for insurance companies who in turn insured producers of agricultural commodities grown in the United States based upon sufficient actuarial data. *Id.* § 508. Crop insurance under the program provides insurance for crop losses due to draught, flood or other natural disasters as determined by the Secretary of Agriculture. *Id.* § 508(a). The insurance also provides catastrophic risk protection where producers are indemnified for crop loss due to a loss of yield or when they have been prevented from planting because of drought, flood or other natural disasters. *Id.*

209. Following the terrorist attacks on 9/11 Congress enacted the Terrorism Risk Insurance Act of 2002 (“TRIA”), Pub. L. No. 107-297 § 101(b)(1), 116 Stat. 2322, 2323 (2002). TRIA was enacted to “protect consumers by addressing market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk.” *Id.* The Act established a terrorism insurance program which was initially a temporary program. *Id.* §§ 102(10), 108(a). Under TRIA, the federal government acted as a reinsurer for a three-year period for acts of foreign terrorism where property and casualty insurance losses from an act of terrorism exceed a threshold amount. *See id.* §§ 101(a)(6), 102(1)(B)(ii). Participation in TRIA is mandatory for those entities meeting the definition of an insurer who must make terrorism coverage available. *Id.* §§ 103(a)(3), 102(6), 103(c)(1)(A). Under TRIA, the federal government is responsible for 90% of the portion of insured losses that exceed the insurer’s deductible that must be paid during each year of the program. *Id.* § 103(e)(1)(A). Importantly, TRIA declares as void terrorism exclusions in property and casualty insurance contracts for participating members. *Id.* § 105(a)–(b).

Some critics have argued that government intervention was unnecessary because the insurance marketplace would have eventually found a solution for the problem. *See* Anne Gron & Alan O. Sykes, *Terrorism and Insurance Markets: A Role for the Government as Insurer?*, 36 IND. L. REV. 447, 448–49 (2003). Commentators have discussed cogent reasons why policyholders may decide not to purchase terrorism insurance coverage under TRIA: (1) the high cost of terrorism coverage; (2) the limited scope of the coverage purchased; (3) the lack of belief that terrorism will strike their business or property; and (4) in the hope that the government will step in and pay resulting losses through a relief program. *See also* John P. Dearie & Laurie A. Kamaiko, *Terrorism Risk Statute*, NAT’L L.J., July 21, 2003, at 17.

One commentator has observed that “[g]overnment insurance programs have historically had adverse economic effects. They have ‘crowded out’ the private sector with infeasible pric-

commentator has observed that “government insurance programs have historically had adverse economic effects. They have “crowded out” the private sector with infeasible pricing, “anesthetized” market innovations, and “created moral hazards.”²¹⁰ Nevertheless, the lessons learned from enacting federal insurance programs for floods can be utilized in enacting federal insurance for hurricanes. The article next discusses the rationale for enacting a federal insurance plan for floods and the rationale for a proposed federal insurance program for hurricanes.

1. Federal insurance for floods

As a result of catastrophic flooding which occurred along the Mississippi River in 1927, the private insurance industry abandoned the market for flood insurance.²¹¹ The catastrophic flooding jeopardized the solvency of many property insurers.²¹² The industry’s aversion to flood risk stemmed from a variety of factors, including: “[p]oor, [i]nadequate, and [i]naccurate [i]nformation [a]bout [f]lood [r]isks;”²¹³ “[r]isk [c]orrelation;”²¹⁴ and “[a]dverse [s]election.”²¹⁵ Re-

ing, ‘anesthetized’ market innovations, and created moral hazards.” Rhee, *supra* note 172, at 600. See also Gron & Sykes, *supra* note 209.

Although TRIA was written to sunset on December 31, 2005, Congress extended the sunset to December 31, 2007 under the Terrorism Risk Insurance Extension Act of 2005 (TRIEA), Pub. L. No. 109-144, § 2(a), 119 Stat. 2660 (codified at 15 U.S.C. §§ 6701–6781 (2005)). Although most of the terms and provisions of TRIEA are substantially the same as those of TRIA, there are significant differences. First, TRIEA increases the insurer deductible. *Id.* § 3(c)(3)(E) & (F). TRIEA reduced the proportion of federal payment in 2007. Although the federal government is still required to pay 90% of insured losses in excess of the insurer deductible in 2006, that amount was reduced to 85% in 2007. *Id.* § 4(1)(B). TRIEA also increases the recoupment amount so that the insurers are required to pay a higher amount back to the federal government. TRIEA § 5. Whereas the TRIA program would take effect for all acts of terrorism that resulted in \$5 million of insured loss, TRIEA sharply increased the program trigger to \$50 million in 2006 and \$100 million in 2007. *Id.* § 6.

Critics see TRIEA as a form of corporate welfare and that the insurance industry should not be given this extra support. See Richard R. Stedman II, *Of Hurricanes and Airplanes: The Congressional Knee-Jerk Reaction to September 11*, 49 LOY. L. REV. 997, 1020 (2003). If left to their own devices, insurance companies will exclude hurricane coverage in various forms from their policies.

210. Rhee, *supra* note 172, at 600. See generally Gron & Sykes, *supra* note 209.

211. John K. DiMugno, Steven Plitt & Dennis J. Wall, *CAT Claims: Insurance Coverage for Natural and Man-Made Disasters* § 13:6 (West 2012) (Daniel Maldonado, contributing author).

212. *Id.* at 13-10 to 13-11.

213. *Id.*; see Scales, *supra* note 191, at 8.

214. DiMugno et al., *supra* note 211; Scales, *supra* note 191, at 9–10.

215. DiMugno et al., *supra* note 211; Scales, *supra* note 191, at 8–9.

garding risk correlation, insurance companies assume a variety of risks within an insurance program which, in turn, lowers the likelihood that all of its customers will file a claim in the same year. Thus, the ability to pool a variety of risks is a bedrock feature of a successful insurance system.²¹⁶ But where the risks are correlated, the beneficial effects of pooling of risks decreases because each insured is more likely to experience the risk due to the same harmful event.²¹⁷ Most casualty losses are uncorrelated. But flooding tends to be highly correlated within a geographical area or areas.²¹⁸ Regarding adverse selection, flood insurance presented a vexing problem whereby the people most likely to buy the insurance against flood losses were also the people most likely to suffer that type of loss.²¹⁹ This can create what has commonly been called a “death spiral” where the unfortunate risk pool begins to attract riskier insureds and deters good risks. The former is getting a good deal and the latter is overpaying.²²⁰ Eventually, this type of “death spiral” will collapse the risk pool because of the inevitable rise in premiums which, in turn, reshapes the pool into an increasingly narrower band of highly risky consumers who can no longer afford an actuarially correct premium.²²¹

Congress intervened in 1968 with the enactment of the National Flood Insurance Act (NFIA).²²² It was Congress’s belief that a flood insurance program with the “large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry [was] feasible and [could] be initiated.”²²³ The NFIA was the federal government’s answer to market failure in flood insurance²²⁴ and filled the vacuum left by insurance

216. DiMugno et al., *supra* note 211.

217. *Id.*

218. *Id.*

219. *Id.*

220. *Id.*; Scales, *supra* note 191, at 8–9.

221. DiMugno et al., *supra* note 211, at 13–11 to 13–12; Scales, *supra* note 191, at 9.

222. National Flood Insurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 592 (codified as amended at 42 U.S.C. §§ 4001–4129 (2012)).

223. *Id.* § 4001(b)(2).

224. Scales, *supra* note 191, at 7. One commentator observed the following:

Market failure may be defined as a condition in which economically rational transactions do not take place. Flood insurance, like any casualty, is not inherently uninsurable. However, it suffers from unusual demand- and supply-side constraints that make it a relatively difficult market for insurers, and they have responded rationally by avoiding it.

Id.

companies leaving the marketplace.²²⁵ In passing NFIA, Congress found that “many factors have made it uneconomic for the private insurance industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions”²²⁶ Congress hoped that the NFIA would “provide flexibility . . . so that . . . flood insurance may be based on workable methods of pooling risks, minimizing costs, and distributing burdens equitably among those *who will be protected by flood insurance and the general public*.”²²⁷

The flood insurance program is administered with cooperation between the federal government and private insurance companies; the private companies carry some of the risk, although the federal government stands ready to reinsure and reimburse excessive losses.²²⁸ The program also requires ongoing actuarial studies to help set the premiums to be charged.²²⁹ The eventual goal of the program is to discourage building in flood prone areas by raising, over time, the premiums actually charged to equal the actuarial cost of flood insurance.²³⁰ Although the program offers subsidized flood insurance, it is designed to operate much like any private insurance company and to eventually eliminate the subsidy. Because the program’s exposure to claims and its premiums must be estimated according to standard insurance practices, and because private insurers carry part of the risk, Congress clearly did not intend to abrogate standard insurance-law principles that affect such estimates and risks.

One commentator has observed that the Federal Flood Insurance Program is a “welfare distribution scheme cloaked in insurance terms.”²³¹ In essence, the source of funding is the same as ex post disaster relief which is paid by the taxpayer.²³² If hurricane catastrophes are funded by general revenue, at least the tax structure could be used to collect a catastrophe pool. This “catastrophe tax” could be structured progressively, allowing for the risks associated with the geo-

225. 42 U.S.C. § 4001(b)(1). The Standard Flood Insurance Policy issued under 42 U.S.C. § 4013(a) is found at 44 C.F.R. § 61, app. A(1) (2012). Significant terms used in the Standard Policy are defined at 44 C.F.R. § 59.1.

226. 42 U.S.C. § 4001(a)(4); see Gary Knapp, Annotation, *National Flood Insurance Risks and Coverage*, 81 A.L.R. FED. 416 (1987).

227. 42 U.S.C. § 4001(d)(2) (emphasis added).

228. *Id.* §§ 4017, 4041–54.

229. *Id.* § 4014.

230. H.R. REP. NO. 90-1585, at 91 (1968).

231. Rhee, *supra* note 172, at 611.

232. *Id.*

graphic region and property value.²³³

This approach would not be insurance in its traditional sense in that the tax would be based upon individual actuarial risk. Rather, it would mirror a pooling arrangement.²³⁴

2. Federal insurance for hurricanes

Some western countries have adopted government-backed programs that provide insurance against natural disasters.²³⁵ Congress considered establishing a federal program of reinsurance that would financially backup state natural catastrophe insurance programs and a bill was submitted in the House of Representatives known as the “Homeowners Insurance Protection Act of 2007.”²³⁶ The purpose of the proposed legislation was “[t]o establish a program to provide reinsurance for State natural catastrophe insurance programs to help the United States better prepare for and protect its citizens against the ravages of natural catastrophes, to encourage and promote mitigation and prevention for, and recovery and rebuilding from such catastrophes, and to better assist in the financial recovery from such catastrophes.”²³⁷ Section two of the proposed legislation contains congressional findings:

The Congress finds that—

- (1) the United States needs to take actions to be better prepared for and better protected from catastrophes;
- (2) the hurricane seasons of 2004 and 2005 are startling reminders of both the human and economic devastation that hurricanes, flooding, and other natural disasters can cause;
- (3) if a hurricane similar to the deadly 1900 Galveston hurricane occurred again it could cause over \$36,000,000,000 in loss;
- (4) if the 1904 San Francisco earthquake occurred again it could cause over \$400,000,000,000 in loss;

233. *Id.* at 612.

234. *Id.* at 617.

235. CONGRESSIONAL BUDGET OFFICE, FEDERAL REINSURANCE FOR DISASTERS 49 (2002), <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/37xx/doc3787/09-20-federalreinsurance.pdf>. For example, both Japan and New Zealand have earthquake reinsurance programs. *Id.* at 49, 51.

236. H.R. 91, 110th Cong. (2007).

237. *Id.* at 1.

(5) if a Category 5 hurricane were to hit Miami it could cause over \$50,000,000,000 in loss and devastate the insurance industry in the United States;

(6) if the 1938 ‘Long Island Express’ were to occur again it could cause over \$30,000,000,000 in damage and if a hurricane that strong were to directly hit Manhattan it could cause over \$150,000,000,000 in damage and cause irreparable harm to our Nation’s economy;

....

(8) using history as a guide, natural catastrophes will inevitably place a tremendous strain on homeowners’ insurance markets in many areas, will raise costs for consumers, and will jeopardize the ability of many consumers to adequately insure their homes and possessions;

(9) the lack of sufficient insurance capacity and the inability of private insurers to build enough capital, in a short amount of time, threatens to increase the number of uninsured homeowners, which, in turn, increases the risk of mortgage defaults and the strain on the Nation’s banking system[.]²³⁸

The proposed legislation acknowledged that some states had to intervene to insure the continued availability and affordability of homeowners’ insurance to its state residents and that efforts to improve insurance availability be implemented at the state level.²³⁹ Private sector insurers and many state insurance entities seek to limit exposure to large losses by transferring a portion of this risk to reinsurers and sometimes to the capital markets through insurance-linked securities, known as catastrophe bonds.²⁴⁰ Other state entities do not use reinsurance or insurance-linked securities to protect against catastrophic losses. These States instead utilize post-event funding mechanisms, including assessments on primary insurers, proceeds from general revenue, and bonds.²⁴¹

The proposed legislation recognized that “while state insurance programs may be adequate to cover losses [for] most natural disasters, a small percentage of events are likely to exceed the financial capacity

238. *Id.* at 2–4.

239. *Id.* at 4.

240. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-10-568R, NATURAL CATASTROPHE INSURANCE COVERAGE REMAINS A CHALLENGE FOR STATE PROGRAMS 1–2 (2010).

241. *Id.*

of [those] programs and the local insurance markets.”²⁴² Moreover, “participation in the reinsurance markets is expensive and results in high premium rates for policyholders, who may therefore decide not to purchase coverage,” but instead utilize post-funding mechanisms.²⁴³ Because post-event funding concentrates all of the risk within the State rather than the broader private market, major natural catastrophes put State finances at risk. Congressional legislative proposals have sought “to either facilitate the transfer of risk from state programs to the broader reinsurance and capital markets or to shift a portion of natural catastrophe risk from the [S]tates to the federal government.”²⁴⁴

The proposed Act “encourage[d] States to create catastrophic funds by providing a federal backstop for those States that voluntarily create state funds.”²⁴⁵ The federal fund was to be named the Consumer Hurricane and Earthquake Protection (HELP) Fund and would provide lower-cost reinsurance to state catastrophic funds.²⁴⁶ Each contract of reinsurance coverage made available under the Act was to cover losses insured or reinsured by eligible state programs caused by:

- (1) earthquakes;
- (2) perils ensuing from earthquakes, including fire and tsunamis;
- (3) tropical cyclones having maximum sustained winds of at least 74 miles per hour, including hurricanes and typhoons;
- (4) tornadoes;
- (5) volcanic eruptions;
- (6) catastrophic winter storms; and
- (7) any other natural catastrophe (not including any flood) insured or reinsured under the eligible State program for which reinsurance coverage . . . is provided.²⁴⁷

Additionally, the proposed legislation provided for a general ac-

242. H.R. 91, 110th Cong. § 2(12) (2007).

243. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 240, at 2.

244. *Id.*

245. *House Reps. Introduce National Catastrophe Insurance Proposal*, INS. J. (Jan. 5, 2007), <http://www.insurancejournal.com/news/national/2007/01/05/75650.htm>.

246. *Id.*

247. H.R. 91 § 6.

counting office study of hurricane-related flooding, including the possibility of expanding the NFIP.²⁴⁸ The proposed federal reinsurance program was referred to the House Committee on Financial Services on January 4, 2007, and has not been heard from since. It died in committee.

There are at least four identified public policy goals for federal government involvement in natural catastrophe insurance. These goals include: (1) charging premium rates that reflect the risk of loss, (2) encouraging broad participation, (3) encouraging the private market to provide natural catastrophe insurance, and (4) limiting costs to U.S. taxpayers.²⁴⁹

Before the devastating 2011 hurricane season, on July 22, 2010, the House considered H.R. 1264, the Multiple Peril Insurance Act of 2009, which would add multi-peril coverage, including optional windstorm coverage, to the NFIP.²⁵⁰ The bill defines windstorm as “any hurricane, tornado, cyclone, typhoon, or other wind event.”²⁵¹ Windstorm coverage would only be available if the structure (and the personal property related thereto) was also covered by flood insurance.²⁵² The Senate never considered the bill, but President Obama had informed Congress that he was opposed to such legislation.²⁵³

248. *Id.* § 15.

249. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-7, NATURAL DISASTERS: PUBLIC POLICY OPTIONS FOR CHANGING THE FEDERAL ROLE IN NATURAL CATASTROPHE INSURANCE (2007).

250. H.R. 1264, 111th Cong. (2009).

251. *Id.* § 6(3). The authors believe that any federal natural disaster insurance program should include coverage not only for hurricanes but also for tornadoes. Damages from tornadoes dominate the list of one billion dollar natural disasters in 2011. See *Billion Dollar U.S. Weather/Climate Disasters*, NAT'L CLIMATIC DATA CTR., <http://www.ncdc.noaa.gov/billions/events> (last visited Dec. 31, 2012). There were an estimated 46 tornadoes over central and southern states (including Kansas, Missouri, Iowa, Illinois, Wisconsin, Kentucky, Georgia, Tennessee, North Carolina, and South Carolina) from April 4 to 5, 2011, with over \$1.4 billion in insured losses and total losses greater than \$2 billion. *Id.* Several days later, from April 8 to 11, 2011, another outbreak of approximately 59 tornadoes struck nine central and southern states, causing over \$1.5 billion in insured losses and greater than \$2.2 billion in total losses. *Id.* From April 14 to 16, 2011, another outbreak of 160 tornadoes struck central and southern states, resulting in over \$1.7 billion in insured losses and greater than \$2 billion in total losses. *Id.*

Less than two weeks later, from April 25 to 28, 2011, an estimated 343 tornadoes struck central and southern states. *Id.* Of the resulting 321 fatalities, 78 occurred in Alabama. Insured losses were greater than \$6.6 billion and total losses of \$9 billion. *Id.* From May 22 to 27, 2011, another 180 tornadoes struck central and southern states with an estimated 177 deaths resulting. *Id.* Insured losses were \$4.9 billion and total losses were more than \$9 billion. *Id.*

252. H.R. 1264 § 2(c)(3)(B).

253. Maria Recio, *Obama Rejects Federal Wind Insurance for Hurricanes*, McCLATCHY

Whether Congress or the President have reconsidered their position on federal hurricane insurance programs is currently unknown.

D. Federal Charter

The McCarran-Ferguson Act's reverse preemptive effect on federal regulation has been the regulatory paradigm that has prevailed for the last six decades. Recently there have been efforts to modify the federal-state demarcation, but none of these efforts have succeeded.²⁵⁴ As an example, in the 1990s insurance brokers and insurance companies insuring large commercial risks urged Congress to enact a federal regulatory system with the goal of reducing "the alleged inefficiencies inherent in dealing with the rules and regulations of fifty different states."²⁵⁵ Concerned with the possible success of these efforts, states responded by becoming more receptive to rate deregulation in commercial markets and in so doing mooted the necessity of establishing a federal regulatory presence.²⁵⁶ In 2001, the American Insurance Association (AIA), an organization representing approximately 300 property and casualty insurance companies, "proposed that insurers be granted the option of obtaining a charter from a federal licensing agency in lieu of being regulated in each state in which they do business."²⁵⁷ Because of the history of states' regulation of the insurance industry as discussed in Parts III(B) and (C), *supra*, there are significant critiques of a federal charter.²⁵⁸

Federal charter legislation was introduced in the United States Senate as part of the National Insurance Act of 2006.²⁵⁹ The purpose of the proposed Act was:

(May 12, 2009), <http://www.mcclatchydc.com/2009/05/12/68042/obama-rejects-federal-wind-insurance.html>.

254. Congress has proposed three different alternatives involving federalization of insurance within the past seven years. See Insurance Consumer Protection Act of 2003, S. 1373, 108th Cong. (2003); State Modernization and Regulatory Transparency Act, Staff Discussion Draft (Aug. 19, 2004), *available at* www.aba.com/aba/documents/abia/ins-summary.doc; National Insurance Act of 2006, S. 2509, 109th Cong. (2006). The National Insurance Act of 2006 was reintroduced to Congress as the National Insurance Act of 2007. H.R. 3200, 110th Cong. (2007).

255. Robert H. Jerry, II & Steven E. Roberts, *Regulating the Business of Insurance: Federalism in an Age of Difficult Risk*, 41 WAKE FOREST L. REV. 835, 838–39 (2006).

256. *Id.* at 839.

257. *Id.*

258. See, e.g., Gregory Arnold, *The Doubtful Impact of an Optional Federal Charter on the Reinsurance Collateral Debate*, 44 TORT TRIAL & INS. PRAC. L.J. 79 (2008).

259. S. 2509 § 1(a).

To authorize the issuance of charters and licenses for carrying on the sale, solicitation, negotiation, and underwriting of insurance or any other insurance operations, to provide a comprehensive system for the regulation and supervision of [n]ational [i]nsurers and [n]ational [a]gencies, [and] to provide for policyholder protections in the event of an insolvency or impairment of a [n]ational [i]nsurer.²⁶⁰

The proposed Act would designate a commissioner of national insurance.²⁶¹ Significant to this discussion is Section 1125, which provides that national insurers “shall not be subject to any form” of state regulation regarding the underwriting of insurance²⁶² or any other insurance operations.²⁶³

The U.S. Treasury Department issued a blueprint for a stronger regulatory structure, including recommendations for federal regulation of insurance, on March 31, 2008.²⁶⁴ The blueprint recommends that Congress authorize an Optional Federal Charter (OFC), which would be issued by a newly established Office of National Insurance (ONI).²⁶⁵

Optional federal insurance charter legislation was introduced into Congress on April 2, 2009.²⁶⁶ Under the proposed Act, “the ONI would regulate national insurers, national insurance agencies, federally licensed producers, and reinsurers.”²⁶⁷ ONI regulations would preempt state laws for ONI regulated entities with regard to licensing, examinations, reporting, and regulations concerning the sale or underwriting of insurance, but would not preempt state laws governing property, taxes, workers’ compensation or motor vehicle insur-

260. *Id.* pmb.

261. *Id.* § 1102.

262. *Id.* § 1125(a)(2).

263. *Id.* § 1125(a)(3).

264. William K. Broudy, Francine L. Semaya & Laurance D. Shapiro, *U.S. Treasury Department Calls for Overhaul of Insurance Regulation*, 907 PLI/COMM. 75 (PLI Order No. 14317, Sept. 17, 2008); see also U.S. DEP’T OF TREASURY, *THE DEPARTMENT OF THE TREASURY BLUEPRINT FOR MODERNIZED FINANCIAL REGULATORY STRUCTURE* (2008).

265. U.S. DEP’T OF TREASURY, *supra* note 264, at 10; see also Broudy et al., *supra* note 264.

266. Elizabeth F. Brown, *The Development of International Norms for Insurance Regulation*, 34 BROOK. J. INT’L. L. 953, 992 (2009).

267. *Id.*; see National Insurance Consumer Protection Act, H.R. 1880, 111th Cong. (2009). Unlike the NIA, the NICPA would provide charters only for life insurers and property or casualty insurers and reinsurers, not health insurers and reinsurers. *Id.* § 301. For more detail about the scope of NICPA regulation, see *id.* §§ 102, 111–17, 301, 401, 501–03 (the scope of regulation).

ance.²⁶⁸

The advantages and disadvantages that an insurance company may receive through a federal charter vis-à-vis state licensure will not be discussed herein. The structure of the federal department of insurance and the powers of the national commissioner of insurance over federally chartered insurance companies is also not discussed herein. What is relevant is that, arguably, if Congress adopts a federal charter, federally chartered insurance companies would most likely not be governed by state moratorium laws.

VI. CONCLUSION

It is unlikely that an insurance company can successfully challenge emergency non-cancellation moratoriums enacted after catastrophic hurricanes in the Gulf states. First, the forum in which the insurance companies will challenge the moratorium laws is state court. This is because the states' Eleventh Amendment immunity will bar insurance companies from suing the states' departments of insurance in federal court. Second, it is unlikely that constitutional challenges will be successful based on the Takings Clause of the Fifth Amendment, Due Process and Equal Protection Clauses of the Fourteenth Amendment, and the Contracts Clause. The demographics of the Gulf states most vulnerable to hurricane loss raise a concern that large cancellations in the residential homeowner marketplace will produce de facto redlining. The prohibition of redlining is an appropriate state action that provides support for the moratorium regulation and significantly undercuts any constitutional challenge due to the presence of a legitimate, regulatable state interest.

State-imposed regulatory non-cancellation moratoriums potentially jeopardize the solvency of affected insurance companies in the Gulf states and other states prone to hurricanes. The policyholders of the affected insurance companies who reside in non-hurricane prone States have a substantial interest in those insurance companies' solvency. If a national or regional insurer becomes insolvent because of another hurricane, all policyholders will be affected beyond the boundaries of the regulating state. State guaranty funds will be stressed from any large insolvency. An even-handed approach would be to create a new federal catastrophe insurance program. There is significant precedent for such a program. Federal insurance programs

268. *Id.* §§ 109(a), 121–23.

work well as social tools to protect against catastrophic events.

Marketplace dysfunction supports the creation of a federal catastrophe insurance program. The concept of risk diversification does not exist when the risk is from a hurricane because every member of the community is likely to be effected adversely at the same time. Only the federal government, through its taxing power, can endure the financial shock of severe catastrophic events.

A federal catastrophe insurance program that would cover all major disasters could be funded through premiums generated from each mortgage loan approved by the Federal Housing Administration (FHA). As further incentive to participate in the program, Congress could require participation in the national catastrophe insurance program as a condition for receiving any governmental disaster assistance. Private non-FHA lenders would most likely require participation in the national catastrophe insurance program as a condition of homeowner loan approval. Adoption of a national catastrophe insurance program would potentially eliminate the need for state non-cancellation moratoriums because the subsidized homeowner's insurance offering would allow affected insurance companies to avoid potentially crippling exposures, such as those recently realized with Hurricanes Andrew, Katrina, and Irene. Indirectly, a national catastrophe insurance program would also fairly protect all citizens throughout the United States against the action of a single state regulatory body that acts only for the benefit of its own citizens to the potential detriment of non-residents. A federal insurance program would also require those citizens who live in a hurricane-prone area to fairly contribute and, at the same time, reduce the amount of financial subsidies by those citizens who do not reside in a hurricane-prone area.

Utilization of a federal charter would not address the financial losses that are caused by a hurricane, but a federal charter would permit federally chartered insurance companies from withdrawing from any hurricane-prone marketplace. A federally chartered insurance company would not be subject to the regulatory limitations that a state might impose in the form of a non-cancellation moratorium. Thus, federally chartered insurance companies would be free to withdraw from hurricane-prone states or be permitted, as federally chartered insurers, to include relevant policy exclusions to protect against the exposures arising from hurricane activity. The result, however, is that there may be less private insurance available for residents in hurricane-prone states and, therefore, more reliance on fed-

eral ex post government disaster assistance for future natural disasters.

The authors call for the creation of a new federal catastrophe insurance program. The program can be funded through charges generated from FHA loans. Private lenders should be encouraged to require participation in the federal program as a condition of loan issuance. State protectionism in the form of regulatory non-cancellation moratoriums should not be permitted because they threaten a broad base of policyholders outside the regulating state, which threatens the peace and security of those policyholders.